Rothschild & Co
Wealth Management

MARKET PERSPECTIVE | FEBRUARY 2025

Wait and see

Foreword

Donald Trump is playing the media like fish on a line. Hopelessly hooked on easy copy, they have to follow his every twist and turn, flip-flopping this way and that, not seeing where they have been or where they are going.

We're trying not to take the bait. As investment advisers we know that the personal does not always translate into the portfolio: whatever our views of the actors involved, geopolitics is not always a big driver of capital markets, which are callously focused on profitability, discount rates and risk appetite. And lost amidst the indignation and trepidation is the possibility of a positive outcome (what we dubbed a Reagan scenario in 2016) – a possibility which does something to counter the more obvious left-sided tail risk.

Trump is no idealogue, but (as he keeps saying) a deal-maker. His words – and some of his actions – are startling, but often designed to alter the behaviour of others, which in turn may change those words and actions. This makes policy analysis difficult, to put it mildly – and that's before we consider that he has only the slimmest of majorities in Congress. Nonetheless, in this *Market Perspective* we outline what we think the main variables may be, and in broad terms how they might affect global portfolios. We also suggest, in our updated ranking of national economic performance, that America may not be so 'non-Great' to begin with.

The immediate uncertainty surrounding the new US administration was one of the reasons our top-down view tactically turned a little more cautious on stocks back in November (by contrast, the coincident uncertainties in European politics – we write with Germany's federal election imminent – seemed less likely to affect global markets, and still do). But we also felt that inflation (and interest rate) risk might revive, and that valuations – and expectations of what Artificial Intelligence can reasonably be expected to deliver – had become a little stretched. These concerns all remain valid, and we remain unusually indifferent, in the short-term, between cash, stocks and bonds.

We have not been able to see a catalyst for a scenario in which other stock indices might consistently do better than the US, even in a becalmed market. A settlement in Ukraine might provide one. Our Reagan analogy suggests that the most belligerent leader can sometimes negotiate or stumble into a peaceful outcome – but our wariness as analysts also warns us against confusing hope with prospect.

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Sources of charts and tables: Rothschild & Co or Bloomberg unless otherwise stated.

Trump gets serious: confusion, commotion and confrontation

"It's déjà vu all over again" – attributed to Yogi Berra

Tariff commotion, executive overreach, questionable appointees, and heckling of the US Federal Reserve (Fed) are all uncomfortably familiar. Call it what you will – Trumponomics, Trumpism, MAGA – it is noisy, and will be with us for the next four years.

We knew Trump would hit the ground running. But the barrage of decrees – across trade, taxation, spending, immigration, and regulation – suggest his economic agenda is taking shape more rapidly than in his first term.

Here we take a look at the unfolding Trump doctrine, some of his likely policy proposals, and what they might mean for the economy and markets, knowing as we write that much of his strategy is being made – and will be re-made – on the hoof.

BIG STICK IDEOLOGY

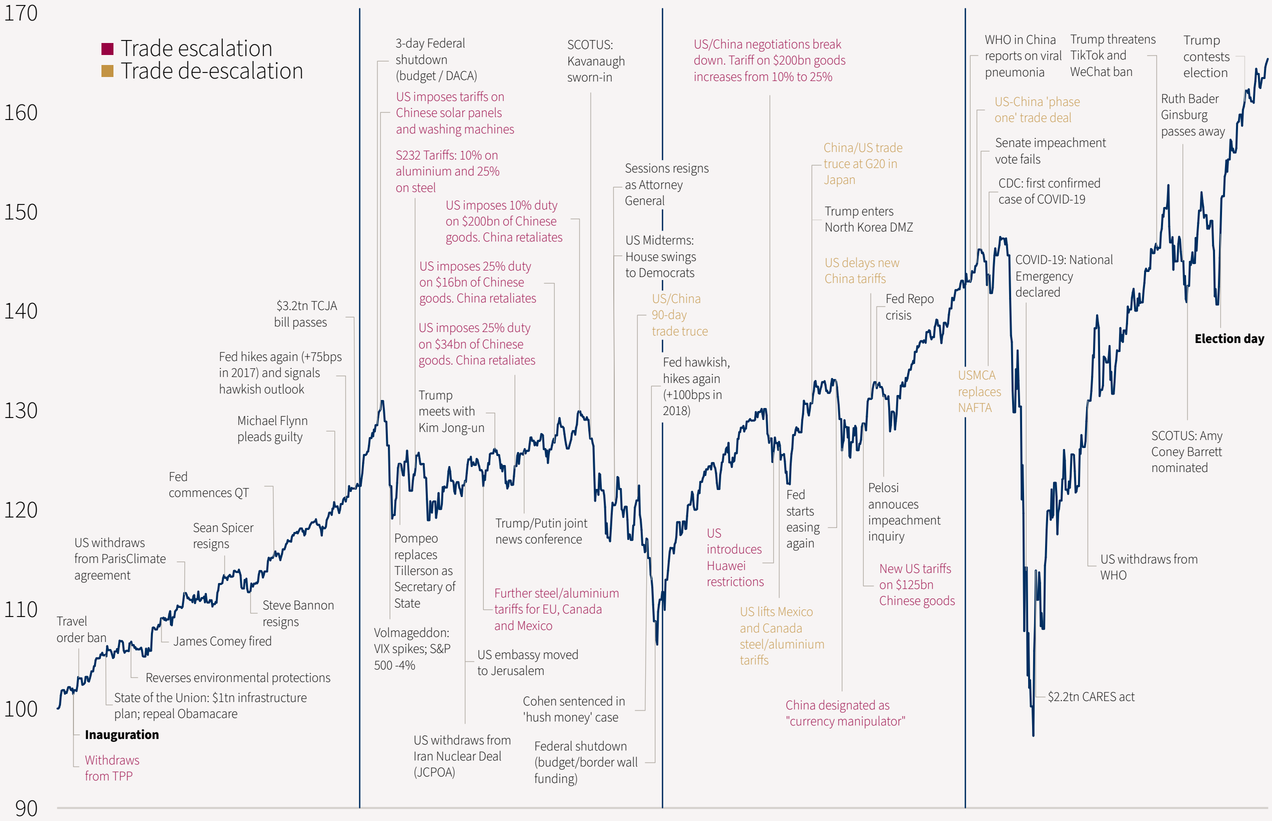
There are many moving parts to Trump's ambitious and contentious policy agenda. And tensions run high on both sides of the debate. His supporters – domestically and globally – are invigorated by his anti-establishment credentials and his 'strongman' pitch to return America to a 'gilded age'. Others see him as a pariah, a belligerent maverick likely to erode democracy, weaken America's international support, and reverse the equality agenda.

There is no doubt that political uncertainty is intense, but some risks are likely being overstated, while possible positive outcomes are being overlooked. Trump is not ideologically driven – a point we have made often. Rather he sees himself as a great deal-maker who can Make America Great Again (whatever that means). The redress of perceived economic grievance, and the prospect of winning in negotiation seems to matter more to him than a particular worldview. His carefully-cultivated 'madman' strategy – the notion that he could do something reckless and impulsive at any moment – is a form of coercive diplomacy, a high-stake gambit as a prelude to negotiation.

In the Trump 1.0 playbook he withdrew from the Paris Climate Accord, initiated trade skirmishes, renegotiated NAFTA, introduced travel bans, and withdrew from the Trans-Pacific Partnership. Such 'shock and awe' policies signalled a more antagonistic foreign policy stance – but their ultimate economic impact was fairly negligible. Even stock markets, which suffered most visibly in 2018 as trade tensions intensified – and the Fed raised rates – retraced their lost ground the following year (figure 1).

FIGURE 1: US STOCKS DURING TRUMP'S FIRST TERM IN OFFICE

S&P 500 index rebased to January 2017



2017: IMMIGRATION; TAX CUTS

Synchronised growth, low inflation and slowly normalising monetary policy. Political concerns retreated: the US administration refrained from protectionism; EU populism faded. Meanwhile, Xi consolidated power in China. Global stocks +22% (Bitcoin surged 15-fold). Corporate profits rebounded, led by energy. US tax cuts moved into focus.

2018: TRADE WAR; FED TIGHTENING

A cocktail of macroeconomic and geopolitical concerns hit investor sentiment hard in late 2018. Trade tensions escalated; 'strongmen' prevailed; 'gilet jaunes' protested; Brexit laboured on. The sugar high from US tax cuts began to fade, while rising interest rates and slowing growth presented headwinds for corporate earnings. Global stocks fell 9% (bitcoin -74%).

2019: DE-ESCALATION; FED EASING

The economic backdrop appeared to stabilise after a near-two-year slowdown, as the Fed unexpectedly shifted back to easing (three rate cuts). Market moves were punctuated by recurring political concerns (US/China, Brexit, broadening civil unrest). Global stocks +27% driven by a combination of favourable base effects, receding tensionsand an improving economic outlook.

2020: COVID

The unprecedented COVID-19 outbreak saw government-dictated lockdowns amid fluctuating contagion/fatality rates, but supportive fiscal and monetary policy led to a market rebound. A big hit to output was also quickly followed by a swift rebound. Global stocks concluded the year at record highs, delivering double-digit returns.

Source: Rothschild & Co, Bloomberg , University of California

We should also remember that Trump 1.0 fell short on many campaign promises, including significantly higher tariff rates, withdrawing from NATO, building a bigger border wall with Mexico, and repealing Obamacare. He did not reverse the multi-decade decline in manufacturing's share of the national economy, though it may have bottomed out.

Nonetheless, we have to take his stance seriously (if not always 'literally'…). There are some subtle, but important distinctions in Trump 2.0. Not only is he (and his team) more familiar with how government works, but he has now remade the Republican party in his own mould – much of it is eager to execute his economic and trade strategy. This is reflected in the rapid and multi-pronged approach since the inauguration.

In contrast to an earlier president, Trump is talking loudly and carrying a big stick. We shall see whether he uses it.

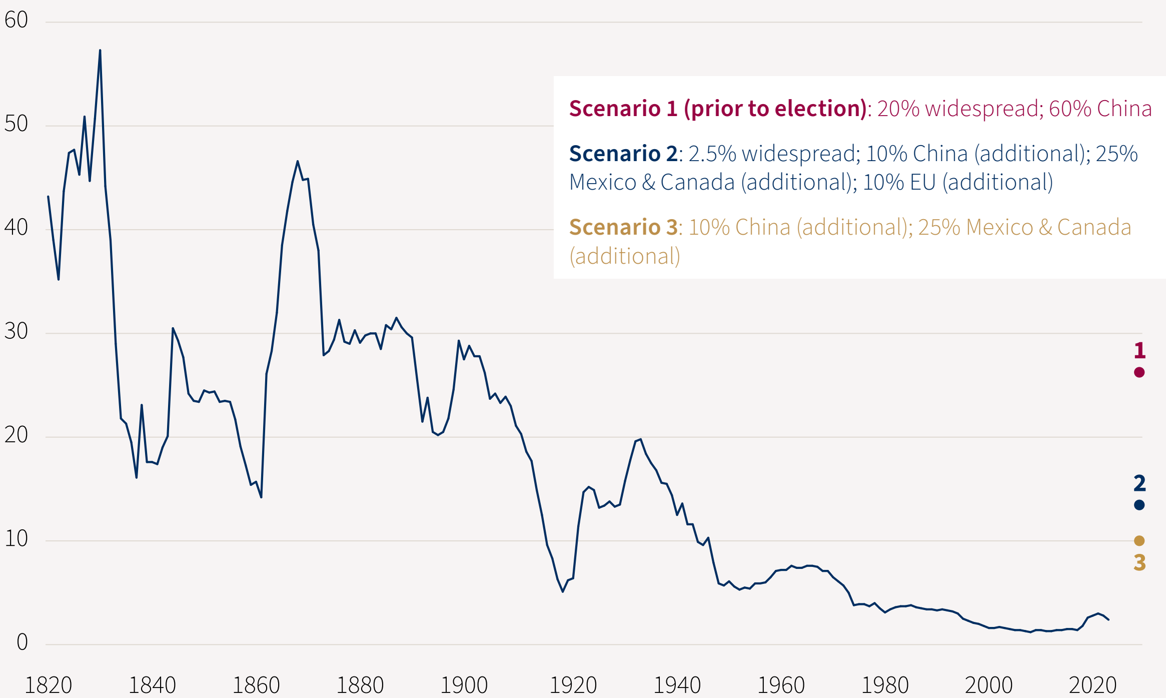
TARIFF MAN

He has been very vocal in his keenness to use tariffs to achieve both economic and political outcomes.

Full-blown trade wars are of course bad for the global economy and business: they put sand in the wheels of commerce, and can restrict choice. The immediate effect of tariffs themselves is to push consumer prices up, though we see their medium-term impact as more likely to be deflationary: unless/until the proceeds are spent at least, such measures reduce spending power. But the scale of the bad news depends on many factors – coverage, duration, incidence – and of course, whether other countries retaliate.

Even now, it is still not clear whether Trump 2.0 tariffs will be widespread or more focused on specific countries and/or products. Meanwhile, what of the reactions of America's trading partners to proposed tariffs? Current skirmishes are not yet a trade war (figure 2).

FIGURE 2: EFFECTIVE TARIFF RATE ON TOTAL IMPORTS AND TODAY'S EX ANTE PROPOSALS
(1821-2023, %)



Source: Rothschild & Co, U.S. International Trade Commission, U.S. Census Bureau
Note: 'Effective Tariff Rate on Total Imports' is defined as duties collected relative to total (duty-free and dutiable) imports.

Trump's protectionist gambit may not play out as feared – indeed, that may be the intention. The threatened 25% tariffs on Mexico and Canada were immediately delayed when both countries seemingly acquiesced to his demands around the 'leaky' borders and immigration. It may not be an attractive strategy – it is certainly a high-risk one – but clearly, Trump's threats need not translate into a full-blown trade war.

He has since followed through with a 10% duty on Chinese goods: China's retaliation so far has been relatively restrained, and again it seems clear that Trump is seeking negotiation (and the proposed 10% is well short of the 60% that was widely quoted on the campaign trail – though of course, that higher rate may yet resurface in due course).

As we've noted before, Trump does have a point in his dealings with China at least: it, not the US, is still the most protected big economy in the world, and is very aware of that. But not all of Trump's policies are reasonable and/or based on careful analysis. The latest salvo on steel and aluminium imports from all sources – where an import duty of 25% is set to be imposed on 12 March – is hard to explain, for example. Even if the administration were able to restore the ~40,000 lost jobs from the steel and aluminium industry over the last two decades, estimates of their cost suggest multiples of the $65,000 average salary in the industry. Other estimates suggest that for every job protected in the steel and aluminium industries, many more jobs will be lost from the downstream industries that buy the more expensive steel (which employ ~6.5 million workers).

Meanwhile, by way of context, the US labour market overall is nearly the tightest in half a century, with unemployment close to historic lows.

TAX CUTS AND DEREGULATION COME AT A COST

The new president's policies are not all potentially harmful for growth.

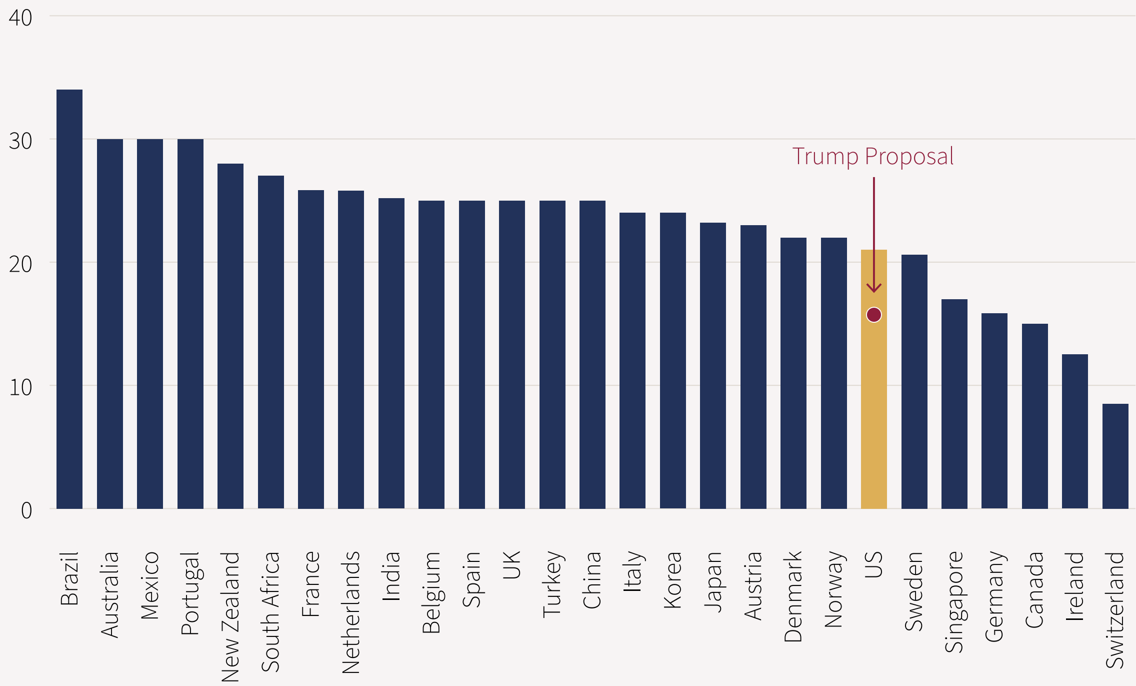
Many of Trump's executive orders have been aimed at cutting red tape, which is seen as hindering competition and raising costs for businesses, and impeding growth. Policies include reducing regulatory friction for banks, such as halting the pending Basel III accords – or cutting bureaucratic largesse (see below). The environmentally thorny 'Unleashing American Energy' policy – known better under the slogan 'drill baby drill' – seeks to reverse many of the Biden era climate-related policies, while encouraging oil and gas exploration.

In addition to deregulation, plans to cut taxes are capable of providing a cyclical boost that could mute or even reverse the net effect of his revenue-raising policies on trade. The biggest component is a proposal to extend the earlier package of tax cuts for individuals (the 2017 Tax Cuts and Jobs Act is due to expire at the end of this year). There are also plans to increase child tax credits, cut taxes on social security payments and provide a higher standard deduction for state and local taxes (SALT). Importantly in the investment context, there is also another planned cut in the corporate tax rate from 21% to 15%.

The administration is seeking to pass these changes via a so-called reconciliation process requiring a simple majority for the passage of the bill. However, the Republican Congressional majority is *thin* (a *three* seat lead in the House and only modestly more in the Senate) and there is growing unease at the scale of the package. The Committee for a Responsible Federal Budget, a cross-party think tank, estimates that it will cost the Treasury $5-11 trillion over the next decade – equating to a non-trivial 2% or lofty 4% of GDP per annum. And this is in the context of a government that is already spending well beyond its current means – the budget deficit is nudging 7% of GDP ($2 trillion). And it is not as if the US is a high tax, high regulation country to begin with – the opposite is true (figures 3 and 4).

FIGURE 3: CORPORATE INCOME TAX RATES BY COUNTRY

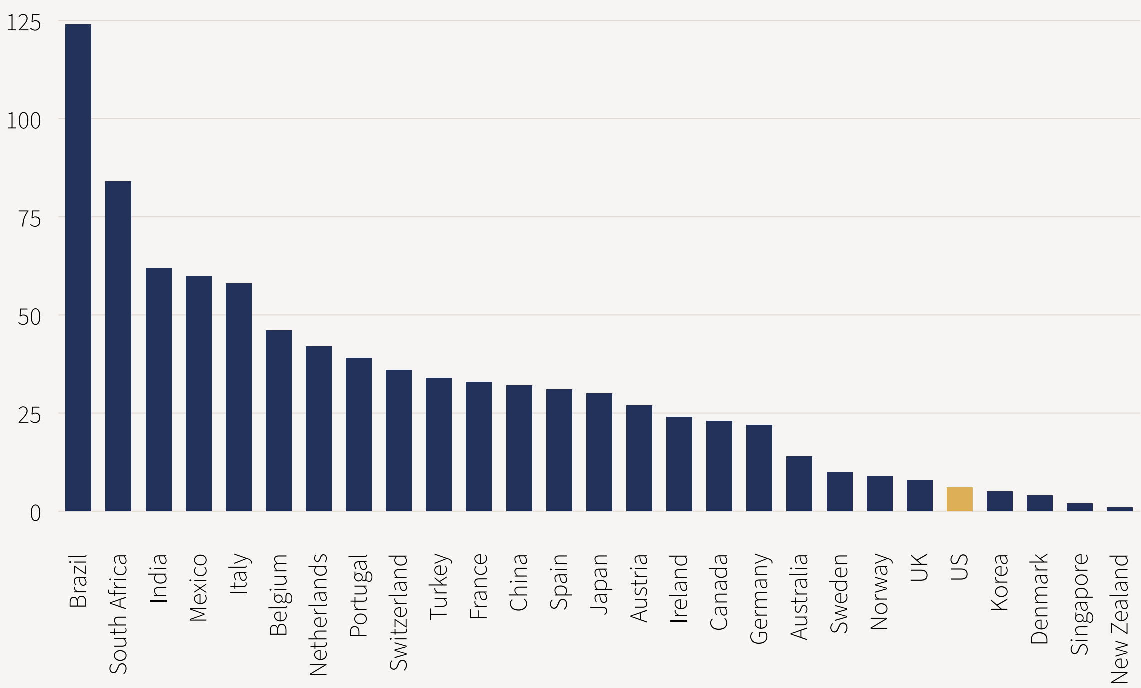
Central government, statutory (2024, %)



Source: Rothschild & Co, OECD

FIGURE 4: EASE OF DOING BUSINESS BY COUNTRY

Rankings (2024)



Source: Rothschild & Co, Bloomberg

MUSK'S GOVERNMENT DOWNSIZING

To address this fiscal shortfall – or at least, to make some room for the tax cuts – the US government is embarking on a big cost-cutting drive, with Elon Musk in charge of the newly created Department of Government Efficiency (DOGE). He has committed to addressing what he calls 'waste and fraud', outlining a number of policies to reduce bloated government spending.

However, questions around conflicts of interest, and the constitutional legality of this newly formed quasi-governmental department, abound. The Democrats have labelled DOGE as an 'unelected' body conducting a 'hostile takeover'. But aside from such concerns, the simple arithmetic hurdles are big.

Some proposed cutbacks are obvious wins. For example, discontinuing the production of pennies and nickels, which have negative seigniorage (each cent costs almost four cents to mint), might save $85 million a year. But this would be less than 0.01% of the $2 trillion in savings (nearly one third of the spending budget) that Musk was initially targeting. Other areas for efficiency gains are more contentious, including restructuring government agencies, offering voluntary redundancy to millions of federal workers and halting federal funding for the US Agency for International Development (USAID) – the latter measure attracting a lot of international criticism.

In 2024 the US federal government spent close to $7 trillion in total, which at 36% of GDP is already considerably less than most of its developed peers. The UK's spending is close to 45%, Germany at 49% and France sits at a lofty 58% of GDP. Mandatory spending – which includes Medicare and Social Security related spending – is effectively politically off limits (even for Trump). Meanwhile, discretionary spending accounts for less than a quarter of the budget ($1.7 trillion), and almost half of that is allocated towards defence (figure 5). Big haircuts will likely face fierce opposition in Congress.

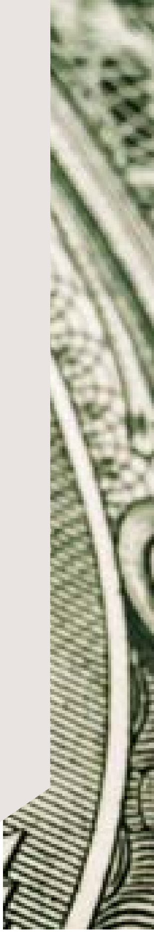
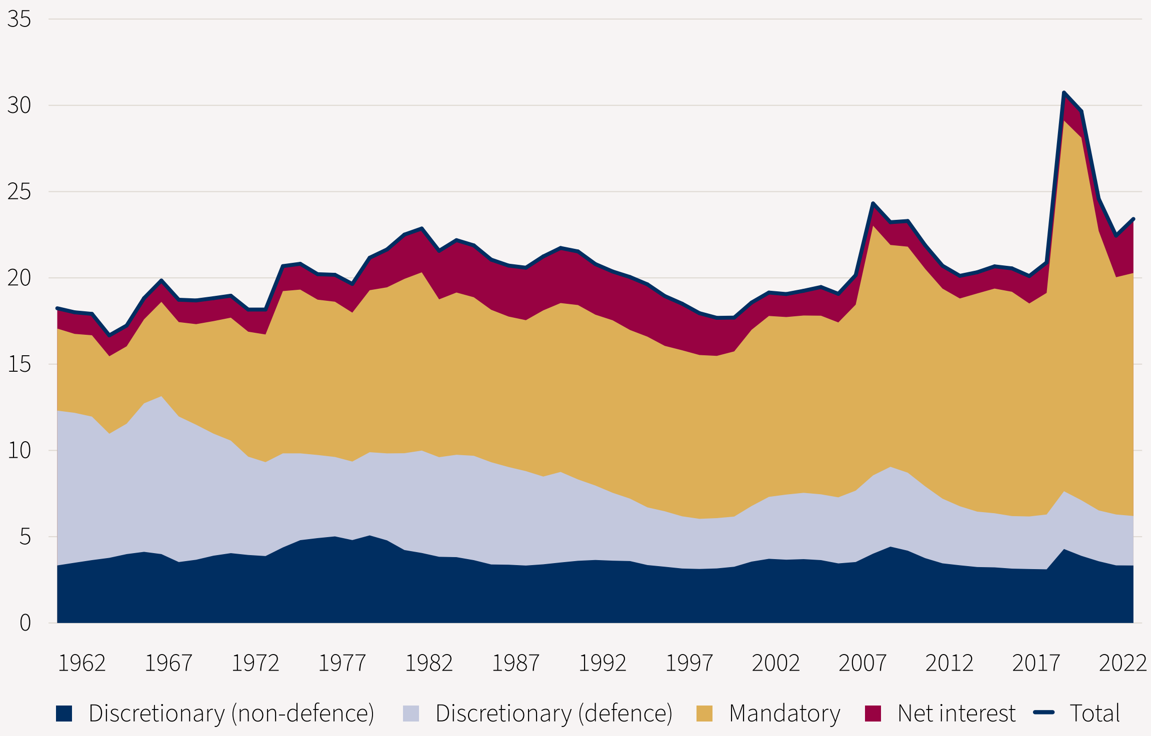


FIGURE 5: US GOVERNMENT OUTLAYS

Relative to GDP (%)



Source: Rothschild & Co, US Congressional Budget Office

Musk is a hugely capable and driven personality, but the US government is not a business and there are legal as well as arithmetic constraints. He has conceded as much in paring back his initial aim of $2 trillion of spending cuts to a more modest, but still ambitious, $1 trillion. We might observe too that Musk is probably not used to being told ‘no’, and he does not need the job.

THE POPULIST PENDULUM

Beyond domestic fiscal and economic considerations, societal strains are very visible. Trump’s return coincides with – for some observers, has been driven by – rising disenchantment with the establishment. The US is not alone in experiencing such disenchantment and revitalised nationalism: euro-populism and Brexit are arguably reflecting the same frustrations.

Indeed, the recently-named Patriots for Europe (formerly ‘Identity and Democracy’) – currently the third largest coalition in the European Parliament – are seeking to Make Europe Great Again (MEGA). This alliance comprises a number of nationalist parties, including France’s National Rally, Spain’s VOX and Austria’s FPO. MEGA has much in common with MAGA – proposals for tighter control of immigration, watering-down climate pledges, and ultimately greater national sovereignty, via changes to the EU’s governance structures.

Trump’s more isolationist stance may also serve to embolden China’s own territorial claims, further destabilising a tense geopolitical scene.

Elsewhere, the outward belligerence and projection of ‘hard power’ around the Panama Canal and Greenland might also seem to further imperil post-war liberal international order, which has been shaped by openness and economic engagement (we say ‘might’ because these are perhaps examples of Trump policies which ought not to be taken literally…).

US DOMINANCE MAY SUFFER, BUT US EXCEPTIONALISM CAN CONTINUE

We have entered a noisier and perhaps more dangerous world. The ‘Disruptor-in-Chief’ appears chaotic and able to operate without impunity. Risking the reversal of decades of international engagement is economically questionable at best. Perhaps most importantly of all, it threatens a breakdown in relations between the world’s two biggest powers, and with the so-called Thucydides Trap looming large in US political discourse this is not something the rest of the world can relish.

However, we have long suggested that the policies of the new US administration may not do as much damage as feared (we said the same of Trump’s first), at least in the narrow world of economics and finance. It is important to remember that checks and balances in the US constitution still exist – as can be seen from the legal and political challenges to recent policies and appointments.

Meanwhile, the business cycle remains friendly, and green shoots are emerging even in the depressed manufacturing sector. And it is not as if the US stock market has been floundering. As we say so often, there are many moving parts in global capital markets, and only a few of those are driven by the occupant to the White House, whoever they might be. We may not admire Trump, but that counts for nothing when it comes to investment advice: the most useful thing we can say as he takes office is to keep an open mind, and watch what happens, not what he says. We are a bit more cautious than usual on stocks, but political uncertainty was only one reason for that stance: we think the outlook for inflation, interest rates, valuations and the next move in the product cycle matter as much if not more.

MACRO PERFORMANCE IN PERSPECTIVE: *ISN'T AMERICA 'GREAT' ALREADY?*

Trump is famously focused on 'Making America Great Again', but his definition of what exactly constitutes 'greatness' is not clear. The POTUS does tend to focus on one specific element of domestic economic performance, namely the US's structural trade deficit, but whether this is all there is to it is not clear.

There is a big and vocal ongoing debate about relative economic performance, but it is sadly not always based on a careful appraisal of data – or if it is, it focuses on just one or two variables only (such as GDP growth, unemployment, or – as per Trump – the balance of payments). In an attempt to cut through the noise, two years ago – at a time when the UK's relative performance was being even more disparaged than usual – we compiled a broadly-ranging scorecard in an attempt to put the big countries' macroeconomic standings into some sort of objective perspective. We grouped 18 variables under three categories: i) 'Prosperity', aimed at gauging growth and material living standards; ii) 'Durability', aimed at the sustainability (not just in the environmental sense) of national economies; and iii) 'Fairness', to cover wider social well-being and equality. We ranked countries under each category, and then took an average of their three rankings across a ten-year window (for the overall score, we took the average across all 18 variables).

We have just updated our rankings (figure 6), which may shed some light perhaps on the scale of what Mr Trump might need to do (assuming of course that our scorecard is a guide to 'greatness'…). The US is roughly mid-table – just in the top half, as it was two years back – and just above the eurozone and UK.

Perhaps unsurprisingly, the US ranks highly, in second place, for 'Prosperity': GDP growth is strong in absolute and per capita terms, as are measures of capital and labour productivity. However, it ranks lower under 'Durability', partly due to its budget and current account deficits, negative net international investment position, elevated government debt ratio and high per capita carbon emissions. (Of course, the current account deficit may largely be a reflection of strong domestic demand, and there is still little sign of 'bond vigilantes' being disheartened by elevated deficits and debt – but these are the criteria we have used, judging that most independent observers would view them as weaknesses.) On 'Fairness', the US is middling: unemployment is relatively low, and measures of human development and political stability are somewhat high – but income inequality (as measured by the Gini coefficient) is one of the widest.

So in a broad, decade-long context, the US doesn't seem to have done that badly. Its stock market – not part of our assessment – has of course topped most tables. Clearly, this is not 'great' enough for Mr Trump.

We will publish a more detailed account of our latest scorecard – and its possible investment implications – shortly.

FIGURE 6: OVERALL COUNTRY RANKINGS

2015-2024 average

	Overall	Prosperity	Durability	Fairness
Switzerland	1	3	1	2
Sweden	2	5	2	3
Netherlands	3	7	4	1
Germany	4	11	3	4
Canada	5	8	8	7
Australia	6	4	14	6
US	7	2	16	9
Eurozone	8	12	5	11
UK	9	9	12	5
China	10	6	10	12
India	11	1	13	13
Japan	12	16	6	8
France	13	14	7	10
Spain	14	10	11	14
Italy	15	15	9	15
Brazil	16	13	15	16

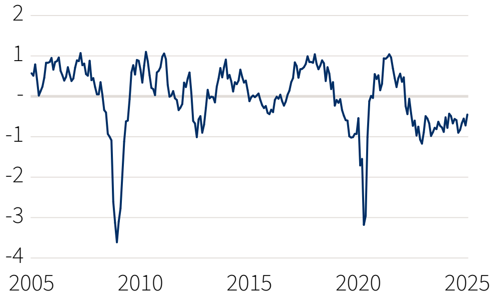
Source: Rothschild & Co, Bloomberg, International Monetary Fund, World Bank, US Census, Conference Board, MSCI, UN Trade and Development (UNCTAD), Global Carbon Project, UN Development Programme

Methodology note: We initially rank 16 countries across each of the 18 variables for each year (2015-2024). We then calculate the average score for each year, then take the overall average across the 10-year window – this average is then ranked to arrive at the 'Overall' country score. The same process is applied to the three sub-categories – 'Prosperity', 'Durability' and 'Fairness' – using only the relevant variables under each heading.

Economy and markets: background

GROWTH: MAJOR ECONOMIES

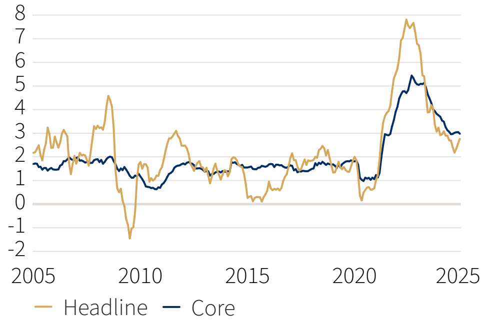
Business optimism: standard deviations from trend



Source: Bloomberg, Rothschild & Co
Composite of the forward-looking components of manufacturing surveys from China, Germany, Japan, UK and US loosely weighted by GDP

G7 INFLATION

Year-over-year (%)



Source: OECD, Bloomberg, Rothschild & Co

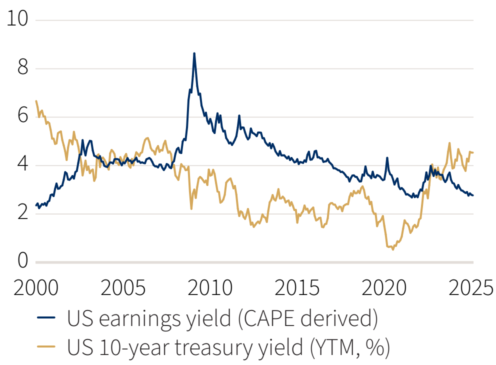
GLOBAL STOCK AND GOVERNMENT BOND RETURNS

Relative returns since 2005 (%)

Source: MSCI, Bloomberg, Rothschild & Co

STOCKS/BONDS — RELATIVE VALUATIONS

(%)



Source: MSCI, Datastream, Bloomberg, Rothschild & Co

EQUITIES

MSCI indices, USD terms

	YTD (%)	2024 (%)
Global	5.0	17.5
US	4.3	24.6
Europe ex UK & Switzerland	11.2	0.7
UK	7.2	7.5
Switzerland	11.3	-2.0
Japan	1.8	8.3
Pacific ex Japan	5.3	4.6
EM Asia	2.5	12.0
EM ex Asia	8.7	-8.2

FIXED INCOME

Current yields and returns, local currency terms

	YIELD	YTD (%)	2024 (%)
Global Govt (hdg, USD)	3.21	0.5	3.0
Global IG (hdg, USD)	4.70	1.0	3.7
Global HY (hdg, USD)	7.28	1.5	10.7
US 10 Yr	4.51	0.8	-0.7
German 10 Yr	2.34	-0.1	0.1
UK 10 Yr	4.45	1.3	-3.0
Swiss 10 Yr	0.35	-0.7	4.2

CURRENCIES

Citi trade-weighted nominal effective exchange rates

	YTD (%)	2024 (%)
US Dollar	-0.7	8.7
Euro	-0.8	-0.1
Pound Sterling	-0.9	4.4
Swiss Franc	-0.7	-2.3

COMMODITIES

	LEVEL	YTD (%)	2024 (%)
Gold (USD)	2928	11.6	27.2
Brent Crude (USD)	75	0.5	-3.1
Gas (EUR)	51	5.1	51.1

Chart data as of 13 February 2025. Table data as of 13 February 2025.

Past performance should not be taken as a guide to future performance.

Table sources: Bloomberg, Rothschild & Co

Important information