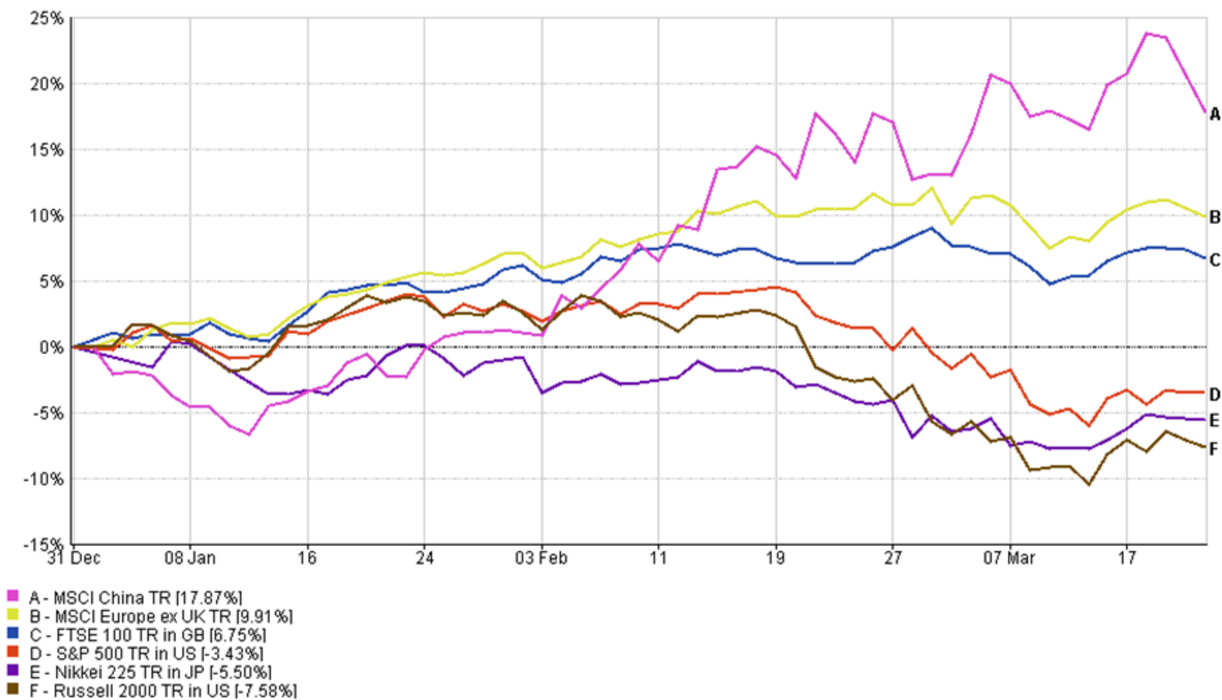
Market Matters - with Tom McGrath

Flying Blind into a Tariff Storm

Markets are flying blind, navigating a macro landscape where the instruments are flashing contradictory warnings. Growth is slowing, inflation remains uncomfortably sticky, and the Fed's latest message, while slightly dovish on the surface, offered little new reassurance. Instead, it reinforced a picture of policy caution in the face of persistent inflation pressures. But the real turbulence may lie ahead. Trump's haphazard tariff policy is adding to the confusion, and with reciprocal measures expected in the coming weeks, investors are bracing for a broader policy shift that threatens to undermine the hopes of a soft landing.

Despite the murky outlook, markets closed the week more positively. A late Friday rebound in Mega cap tech helped the S&P 500 turn green, erasing an earlier 1% decline and closing modestly higher. Tesla led the bounce, while Nvidia cooled off after its recent run. Over 21 billion shares changed hands in Thursday's session, the busiest trading day of the year- Triple Witching - as a massive options expiry amplified volatility. Still, on the week, the S&P 500 gained 0.2%, the Nasdaq rose 0.5%, and the EuroStoxx 50 advanced 1.1%, supported by a rebound in European cyclicals. The FTSE 100 edged up 0.3%, while China's CSI 300 slipped 0.6%, giving back some recent gains amid mixed stimulus and trade policy signals. Year to date, we still see US equities lagging other markets.

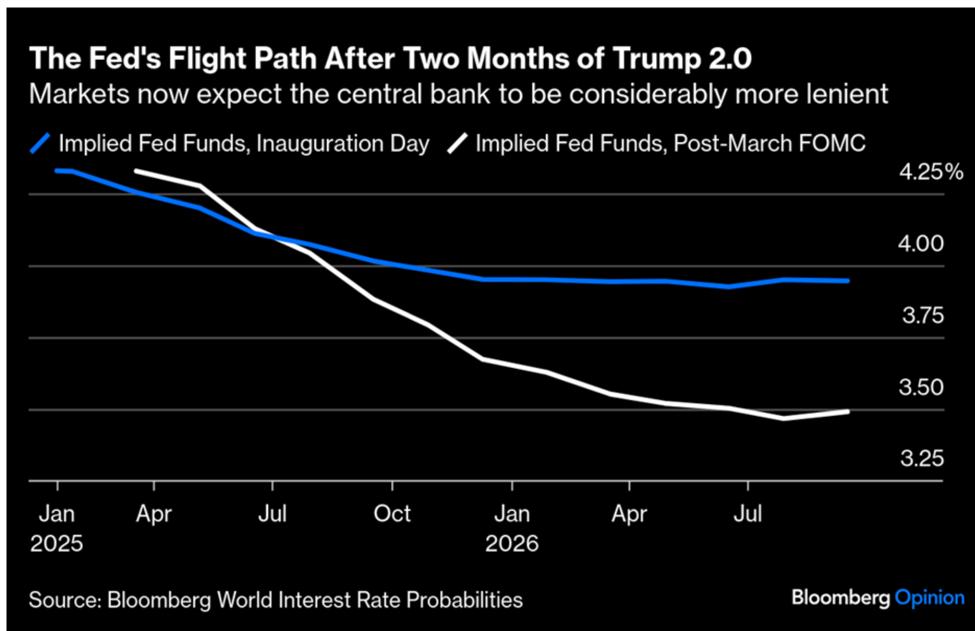


The Fed - Not a Pivot, but a Pragmatic Adjustment: At last week's March FOMC, the Federal Reserve kept rates unchanged at 4.25% to 4.5% while announcing a slowdown in the pace of quantitative tightening. The monthly cap on Treasury redemptions will fall from 25 billion dollars to 5 billion from April. Powell described the adjustment as technical and aimed at managing liquidity, but markets viewed it as a modest step towards easing.

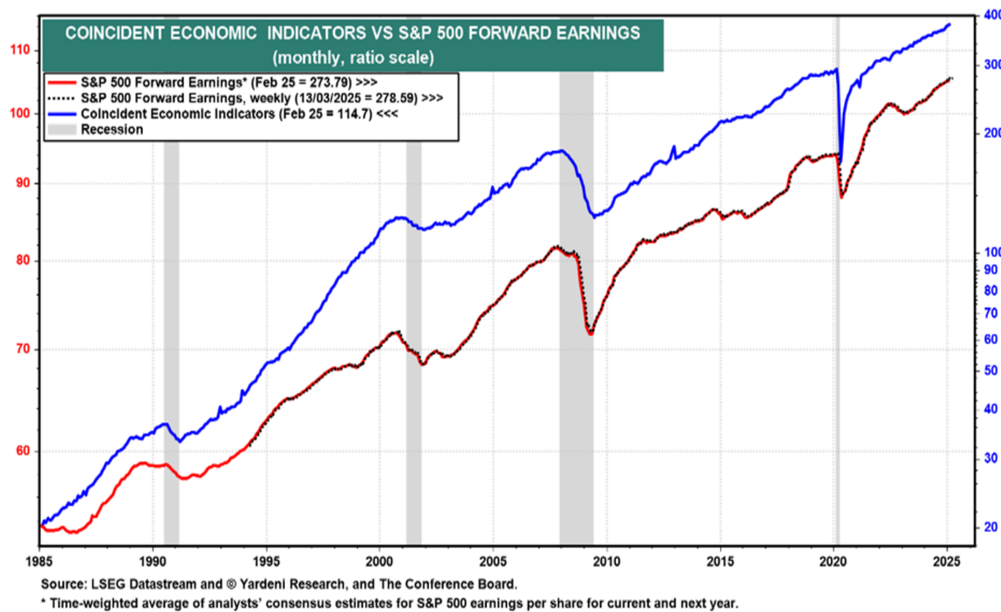
The statement introduced new language, noting that 'uncertainty around the economic outlook has increased' and replacing the earlier reference with balanced risks. Powell leaned heavily into that message in his press conference, using the word 'uncertainty' sixteen times and citing trade policy as a key factor. With new US tariffs due in early April and little clarity on scope or retaliation, the Fed is preparing for more volatility in growth and inflation outcomes. That shift, along with the downgrade to 2025 GDP growth from 2.1% to 1.7% and a bump in core inflation to 2.8%, highlights the reason the Fed is treading very carefully with policy decisions and communication.

The dot plot continues to show a median projection of two rate cuts this year, but the distribution has shifted. Fewer members now expect more than two cuts; more see only one or none. Nevertheless, since Trump entered the White House, the implicit expectation of rate cuts has increased.

Powell was careful not to commit to any path but did push back on recent inflation fears, calling the sharp rise in consumer inflation expectations an 'outlier'. He also revived an old line, suggesting that any inflation caused by tariffs could be transitory. That choice of words did not go unnoticed, given how that term defined the Fed's misreading of the 2021 inflation shock. Markets nonetheless took it as a sign that the Fed is unlikely to react aggressively to near-term price spikes driven by policy.



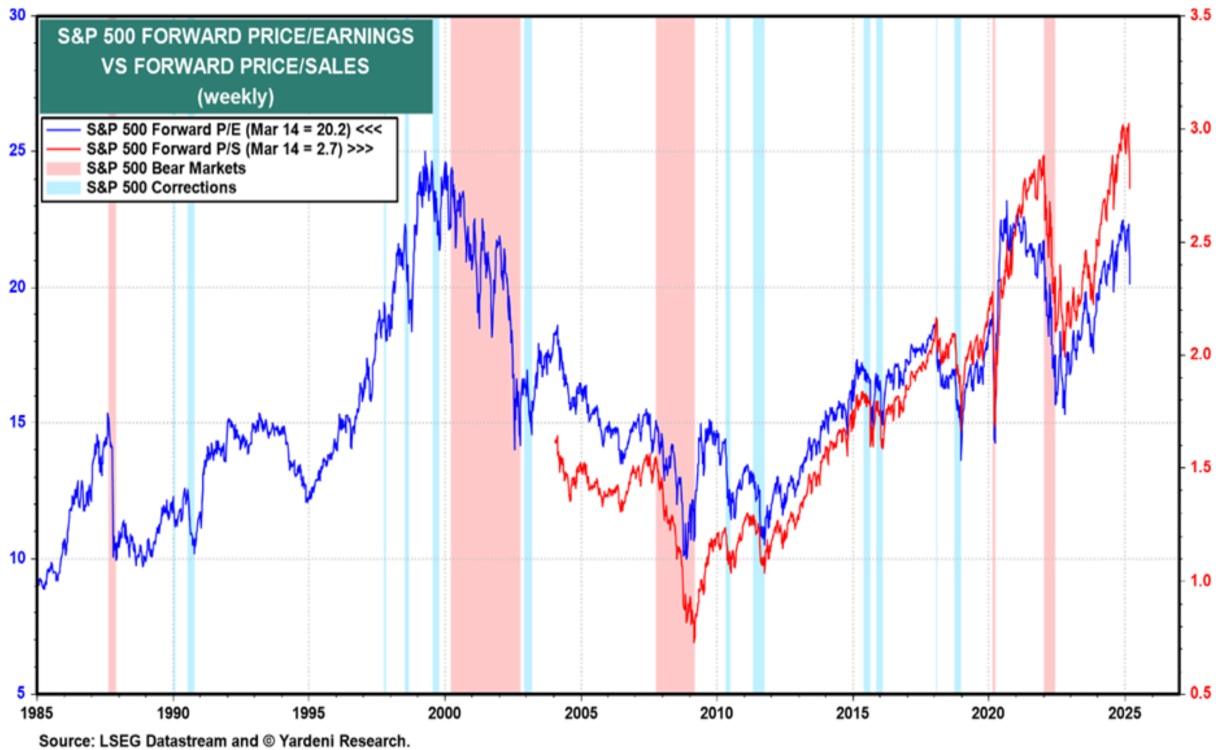
US Economic growth holding up… for now: This week's economic data pointed to ongoing resilience but also suggested that momentum may be fading. The Index of Coincident Economic Indicators rose 0.3% in February to a new record high, in line with the continued rise in forward earnings. Jobless claims remain low at 223,000, with continuing claims broadly stable, reinforcing the strength of the labour market and the consumer.



Existing home sales rose 4.2% in February, beating expectations, although year-on-year growth remains negative. Rising inventories and slowing pending sales suggest the housing rebound may struggle to extend beyond the spring unless yields stay anchored and mortgage rates remain supportive. Manufacturing data was mixed. The Philly Fed's March survey showed elevated activity and a sharp pickup in employment, but input price pressures rose again, and new order expectations dropped to their lowest level since May 2023. Tariffs were increasingly cited as a factor behind rising costs.

The Fed's revised growth forecast reflects this picture. GDP is now expected to expand by 1.7% this year, down from 2.1% in December. That represents an evident slowdown but is not recessionary. For now, the economy is still absorbing higher rates and external shocks without stalling. But the risks are building. **If tariffs take hold and confidence softens further, the growth outlook could deteriorate more quickly than expected. That matters for equity valuations.**

Valuations & Bear Markets: Historically, bear markets tend to coincide with recessions. Corrections, on the other hand, often occur when growth fears rise but ultimately prove overdone. The drop in forward P/E from a peak of 22.3 in December to 20.2 last week reflects that shift in sentiment, especially as the risk of tariff escalation has become more real.



Investors remain divided. Some see tariff threats as a strategic move as part of a negotiation tactic that will ultimately lead to deals or be walked back under political pressure. Others worry that by the time any reversal happens, the economic damage may already be done. That tension is now being reflected in valuations. Multiples remain high by historical standards, but they've started to compress as growth concerns and policy uncertainty increase. The odds of a recession are low for the moment, so we stick to our view that this will go down as a correction rather than early warnings of a Bear market.

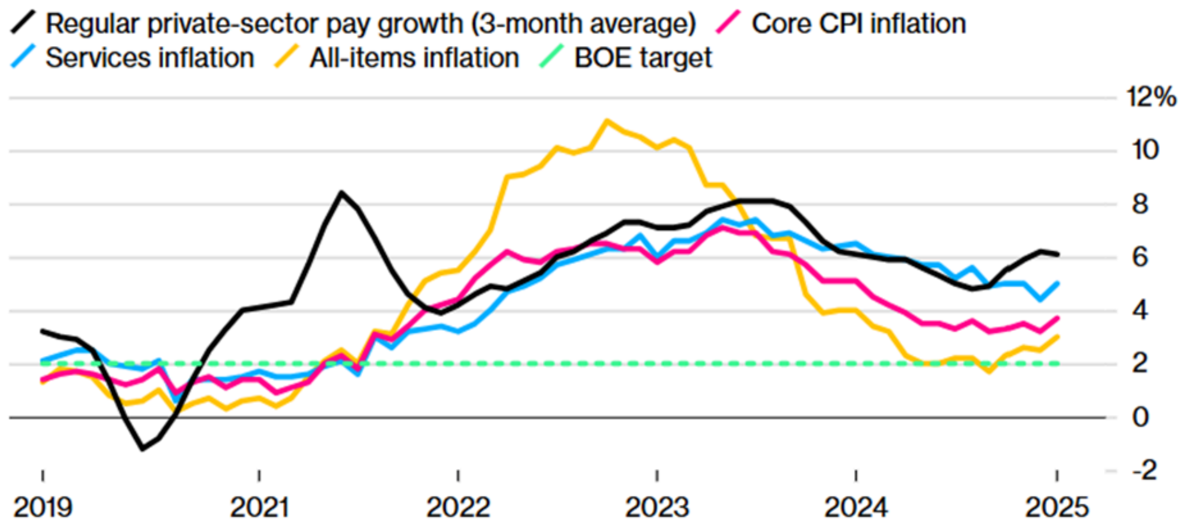
Earnings for Q1 are about to hit: My hope is that earnings can hold up long enough this year for the good news to land, namely, Trump's Big Beautiful Bill. The administration's tax cut proposal remains the centrepiece of its pro-growth pitch, but without clarity on scope, timing, or political viability, it's still more campaign slogan than market anchor. Until then, valuation risk remains front and centre. If tariffs widen and sentiment weakens, multiples could compress further. But the bigger concern may be if the earnings trajectory itself starts to slip, which would not be good, and so far, it seems not to be particularly large on the radar of investors.

Consensus expects Q1 to mark the fourth straight quarter of year-on-year earnings growth, led by tech, healthcare and comms. But expectations have crept higher, and that sets up a soft underbelly. The numbers may print fine, but the tone of guidance is likely to carry more weight than the reports themselves. If CEOs start pointing to rising input costs, softening demand, or worse go dark on forward guidance the market won't take it well. My hunch is that Q1 just about holds together. However, Q2 could be when consumer weakness and trade policy begin to bite. Ironically, by then, we might be closer to fiscal tailwinds and more constructive company outlooks, assuming earnings haven't already done the damage.

UK - Hawkish hold as wage pressures persist: The Bank of England left rates on hold at 4.5% last week, but the shift in tone was notably hawkish. Two members who had previously voted for cuts switched back to the majority, and only one member, Swati Dhingra, maintained her call for an immediate reduction. Governor Bailey warned that monetary policy must be carefully calibrated amid fast-moving global events, including the potential inflation shock from new US tariffs. He reiterated that while **inflation is gradually falling, the path ahead remains uncertain.**

That caution was reinforced by fresh labour market data showing little sign of cooling. Average weekly earnings, excluding bonuses, held at 5.9% in the three months to January, matching a nine-month high. Private-sector wage growth edged down only marginally to 6.1%. Employment also surprised on the upside, with payrolled workers rising by 21,000 in February despite recent tax hikes and higher minimum wage costs. Vacancies rose for the first time since mid-2022, and unemployment remained at 4.4%. **For a central bank still watching wage settlements closely, the data offered few reasons to rush into easing.**

The MPC acknowledged that policy is not on a preset path and made clear that any shift toward cuts would be gradual and conditional. **The Bank now expects inflation to rise back to 3.75% later this year,** and while much of that is attributed to temporary factors, concerns remain about the stickiness of underlying pressures and elevated inflation expectations among firms. Gilt yields rose on the decision, and **markets trimmed their rate cut expectations to around 45 basis points by year-end.**



Chancellor Rachel Reeves will now deliver her Spring Statement against a delicate fiscal and political backdrop. Having left herself with just £9.9 billion of headroom in her October budget, a buffer has since been eroded by weaker growth and higher borrowing costs. Reeves is expected to announce a package of spending cuts to restore some fiscal margin and reinforce Labour's credibility with markets. Behind the scenes, officials acknowledge the need to act after October's budget sparked concerns about sustainability. Tax rises remain on the table for the autumn, but **the emphasis remains focused on 'restraint' for now.**

The political challenge is real. Welfare cuts have already triggered criticism from Labour's backbenches, and further consolidation could test Reeves' standing inside the party. But she appears determined to avoid loosening her self-imposed rules. **The broader strategy is to restore discipline and pivot to growth delivery later**, a message likely to be repeated on Wednesday. For markets, the key takeaway is that the UK remains cautious on both fiscal and monetary fronts, with the BoE in no rush to ease and the Chancellor focused on credibility rather than giveaways. **That mix may offer stability as global policy risk continues to build elsewhere.**

And over in Europe - Germany opens the fiscal taps

While other economies grapple with monetary policy confusion, Europe's shift is happening on the fiscal side. Last week, **Germany passed a landmark investment package through both houses of parliament, unlocking hundreds of billions in deficit-financed spending for defence and infrastructure.** The cross-party alliance between Friedrich Merz's conservatives, the Social Democrats, and the Greens signals a rare moment of consensus and a decisive break from Germany's post-2010 austerity stance.

The investment push is partly a geopolitical pivot. With Trump pulling back from US security guarantees and Russia rearming, Berlin is accelerating its military build-up while pushing to keep defence spending within Europe. However, the package also targets domestic growth, aiming to address two years of economic stagnation, decaying infrastructure, and high industrial costs. Contracts are expected to favour European manufacturers, offering a potential tailwind for regional defence and aerospace names. **The rotation out of US tech continues to support European equities, but I sense a pause in that move for the time being.**

This week... brings the UK Spring Statement, where Rachel Reeves will attempt to reassert fiscal control without triggering political backlash. **Expect a focus on spending restraint over stimulus.** In the US, the countdown to Trump's tariff announcement on April 2 continues with markets on edge for details on scope, timing, and retaliation risk. **We'll also get final Q4 GDP revisions, PCE inflation data, and another round of Fed speak,** which could further clarify how seriously the FOMC is taking tariff-linked inflation.

TOM MCGRATH
Chief Investment Officer & Portfolio Manager

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