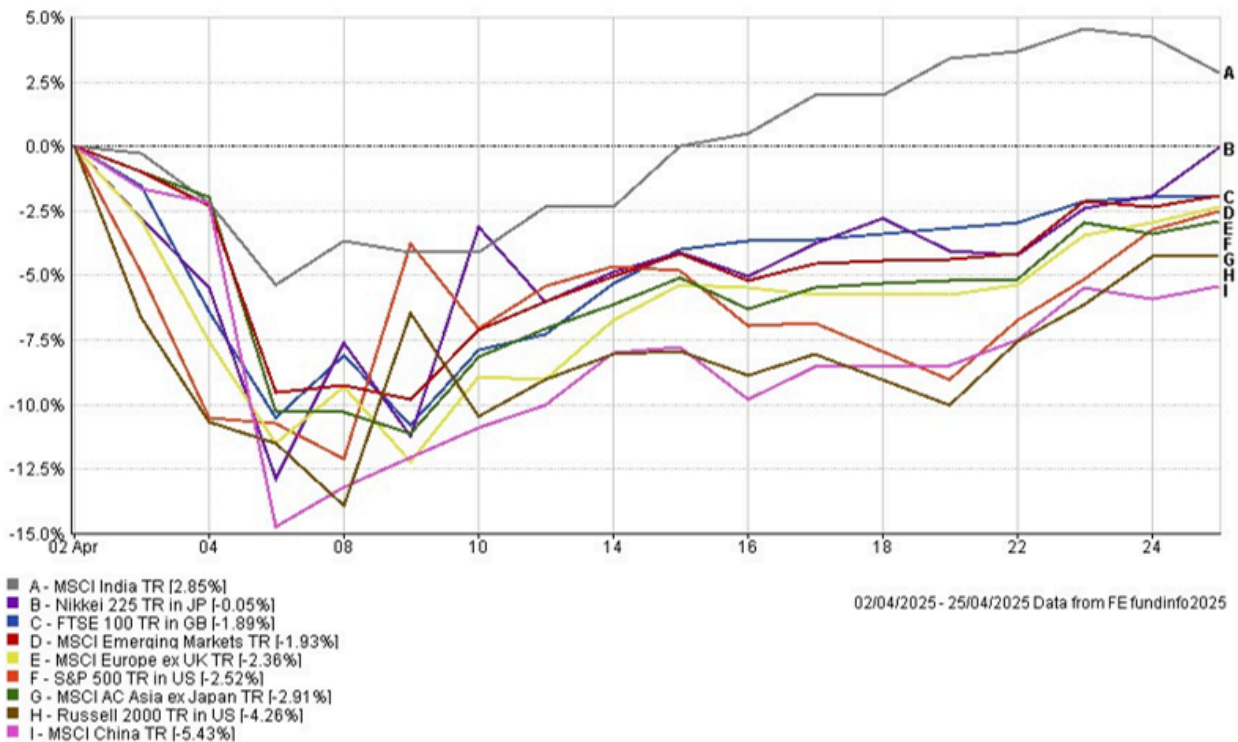


Market Matters - with Tom McGrath

Calm Continues for Now

Markets caught their breath last week, helped along by a softer tone from Washington. Equities bounced back firmly, bond yields slipped, and even the US dollar managed to stabilise after a difficult stretch. The change in mood came as President Trump eased up on his tariff threats against China and reined in his attacks on the Federal Reserve's independence. Although nothing definitive was agreed, the White House's more measured language was enough to stop the selling pressure that had gripped global markets earlier in the month.

Equity Markets Since 'Liberation Day' April 2nd in Local Currency



The relief was palpable across risk assets. US equity indices recovered most of the ground they had lost following the initial tariff announcements at the start of April. Bond markets, which had seen yields spike higher on fears of persistent inflation, settled lower as investors took comfort from the notion that the Federal Reserve would not be pushed into political interference. Even the US dollar, which had been on a steady downward slide, found support and managed a modest bounce.

That said, reading too much into the rally would be unwise. Beneath the surface, the macroeconomic backdrop remains fragile. Growth expectations have cooled, and there is no shortage of risks still hanging over markets. Trade policy remains a moving target, monetary policy is finely balanced, and geopolitical tensions, particularly around China and the Middle East, show no sign of going away. The underlying assumption driving last week's rally was that Trump will ultimately back down from the harshest tariffs and that the US economy will be resilient enough to avoid slipping into recession. Both of those assumptions could still be tested.

Policy developments continue to set the tone for markets. The decision to pause the introduction of new tariffs brought relief, but the existing measures remain firmly in place, and the threat of further escalation has not been removed. Talks with China are ongoing but tense, and there is little sign of genuine compromise from either side. Meanwhile, the Federal Reserve is widely expected to leave rates unchanged at its meeting next week. The bigger question is what officials make of the latest data and whether their projections shift at the next update in June. Inflation expectations among households have picked up sharply, although financial markets remain more sanguine. It is an uncomfortable divergence that could spell trouble if it persists.

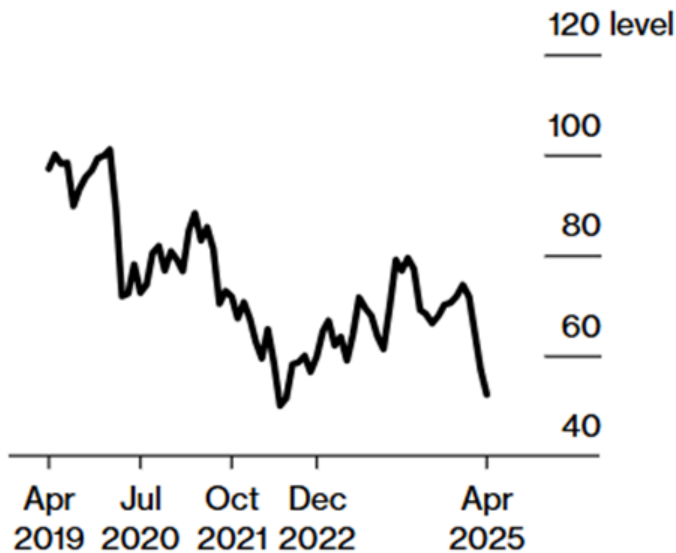
Economic & Sentiment Indicators

Economic data released last week painted a mixed picture. The University of Michigan's April survey showed a sharp drop in consumer expectations, the steepest three-month fall since the early 1990s.

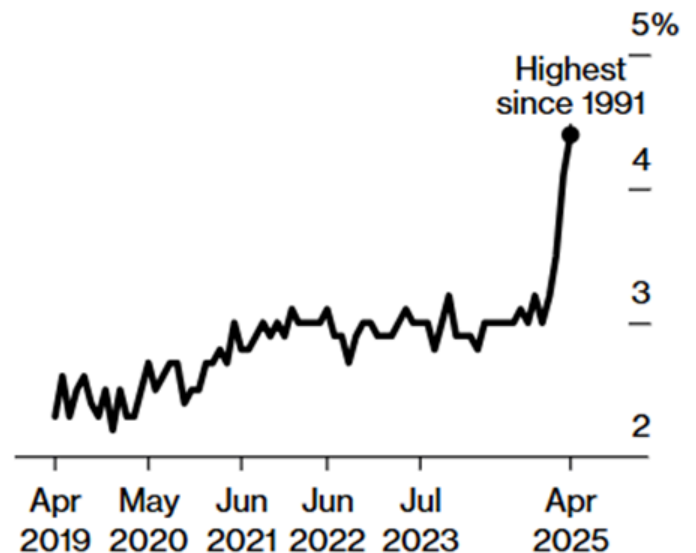
US Consumer Sentiment Continues to Languish on Tariffs

Long-term inflation expectations soar to highest level in decades

Consumer sentiment index



Five- to 10-year inflation expectations



Source: University of Michigan

Consumer sentiment has become increasingly sensitive to the twists and turns of trade policy, and while the direct link between sentiment and spending is not perfect, a sustained deterioration would eventually take a toll on consumption, which remains the cornerstone of the US economy.

On the business side, investment indicators have softened. New orders for non-defence capital goods, excluding aircraft, declined in February and March, reversing earlier gains. Businesses appear to be holding back on investment plans, waiting for greater clarity on tariffs and broader trade policy. Although the labour market remains solid, with low levels of layoffs, there are growing signs that hiring plans are being reassessed. Companies are understandably wary of committing to major projects while the global trade landscape remains so unsettled.

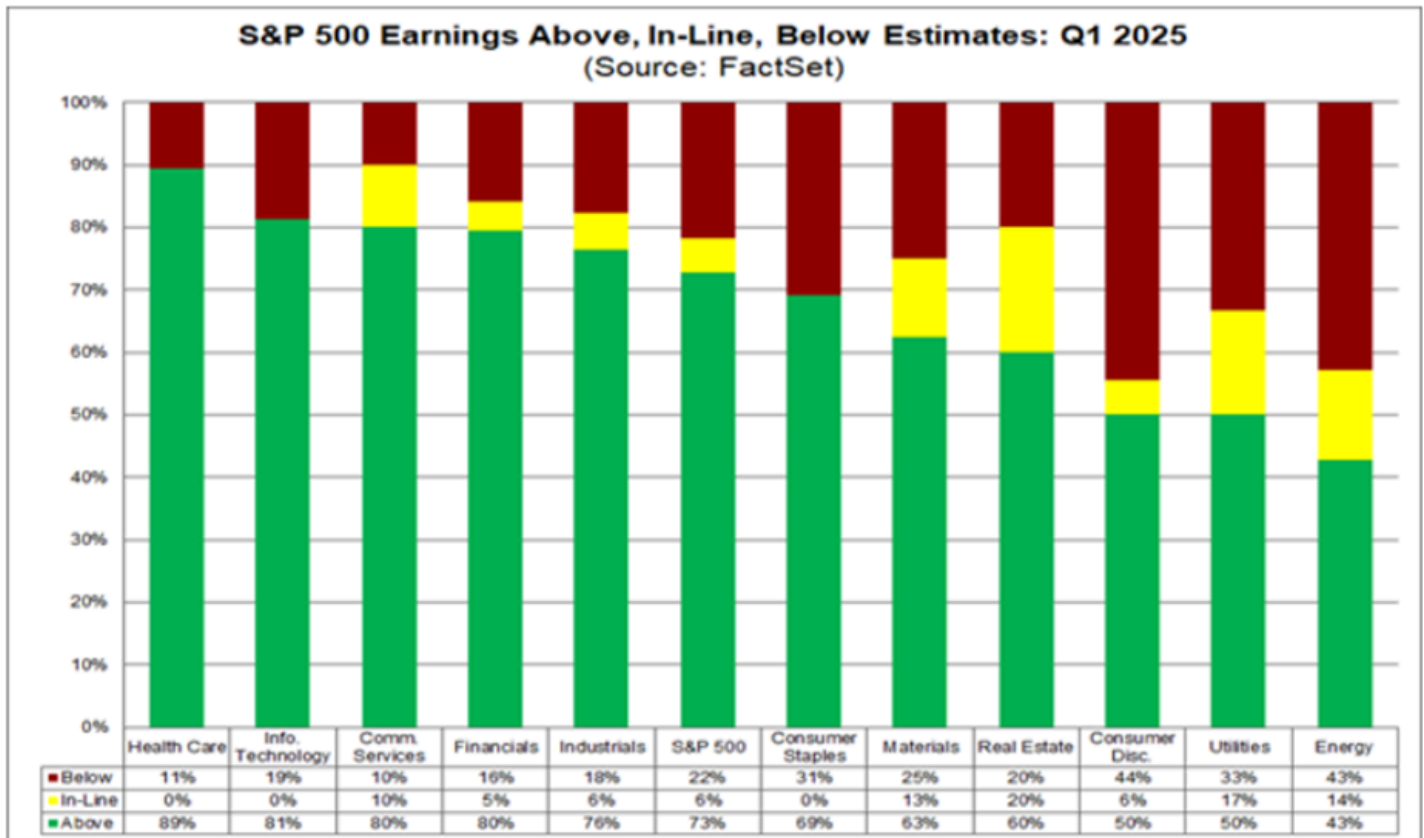
Globally, growth prospects have lost momentum. Forecasts still point to slower expansion rather than outright contraction, but the risks are tilted to the downside. Europe and the UK might see some benefit from companies redirecting investment away from the US, but it is unlikely to be enough to change the overall picture. China, meanwhile, continues to manage a delicate balancing act, trying to support domestic demand without stoking excessive debt.

Corporate Earnings

Turning to corporate earnings, results have offered a supportive backdrop for markets. As of Friday, just over a third of companies in the S&P 500 had reported first-quarter results. Around 73% have beaten earnings expectations, slightly below recent averages, but the magnitude of earnings surprises has been robust. Reported earnings are coming in around 10% above consensus forecasts, and the blended earnings growth rate for the quarter has risen to just over 10% year-on-year, up from the 7% expected at the end of March.

Technology has been the standout sector. Alphabet delivered stronger-than-expected revenue and profits, supported by resilient advertising demand and significant investment in artificial intelligence. Capital expenditure surged by over 40% year-on-year as the company reaffirmed its commitment to building the infrastructure needed to support future growth. Microsoft also posted a strong set of numbers, with its Azure cloud platform growing at a healthy clip and AI initiatives driving renewed demand for enterprise services. Tesla's report was more mixed, with revenues and margins under pressure from aggressive price cuts and softer demand. Still, markets chose to focus on Elon Musk's renewed commitment to the company and plans for future model launches, sending the share price sharply higher. Intel was a notable laggard, warning of weaker demand ahead and highlighting the challenges of trade tensions and global supply chain disruptions.

Q1 2025: Scorecard



Outside of technology, the picture has been more uneven. Financials have generally delivered better-than-expected results, helped by strong trading revenues and still-resilient credit conditions. Health Care has also been a bright spot, with robust earnings growth and positive revenue surprises. On the other hand, Energy companies have struggled, weighed down by lower commodity prices and concerns over future demand.

The resilience of Big Tech earnings has been a key driver of the market's recent gains. However, it must be noted that much of the market's relief rally rests on a fairly narrow foundation. If hopes of a de-escalation in the trade war are dashed, or if evidence of a broader economic slowdown starts to build, the current optimism could quickly fade.

For now, markets are giving policymakers the benefit of the doubt, but it would not take much to reignite concerns.

What about over here?

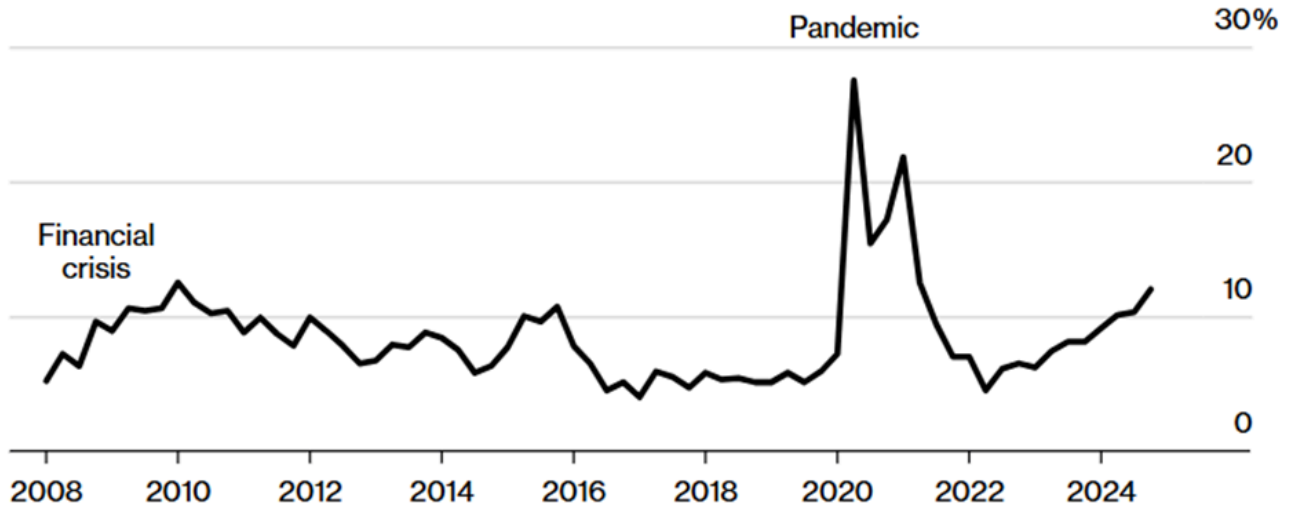
UK markets largely followed global trends last week. Equities moved higher, bond yields drifted lower, and sentiment improved modestly. Retail sales for March provided some encouragement, posting a 0.4% monthly gain following a slightly downwardly revised 0.7% increase in February – that left retail sales growth for the first quarter at 1.6% overall. Clothing retailers had a particularly strong month, helped by good Spring weather, but growth was reasonably broad-based across the non-food sector.

At face value, the retail sector has made a strong start to 2025, although there are reasons to believe that the data slightly overstates the underlying trend. Nearly all the growth over the past year has come in the most recent quarter, and seasonal adjustment issues could be flattering to the early-year numbers. Nevertheless, the resilience of consumer spending in the face of ongoing challenges is notable.

2025 will likely be a year of modest growth for the consumer sector. Real wage growth should remain positive, albeit slowing, and while households are expected to save a little less, global uncertainty could still temper spending somewhat. Despite some gloomy headlines, consumer fundamentals remain reasonably solid, supported by high saving rates and improved balance sheets.

UK Consumers Are Saving More of Their Disposable Income

✓ Saving ratio



Source: Office for National Statistics

Economic forecasts from institutions such as the OBR and MPC have tended to be too cautious, particularly on growth and inflation. Inflation for April, due on 22 May, is likely to come in lower than the MPC's 3.6% forecast, closer to 3% in our view, reflecting energy and utility price changes. Growth also looks to be running ahead of earlier expectations.

Given these developments, the interest rate policy appears too tight. With base rates at 4.5%, well above levels in the Eurozone despite similar inflation rates, the Bank of England faces pressure to adjust. It would be no surprise if the MPC began to lower rates soon, and a larger-than-expected move cannot be ruled out.

Finally, while confidence surveys have softened recently, actual spending data suggests a more resilient backdrop. Retail sales continue to beat forecasts, and consumer activity remains stronger than sentiment surveys might suggest. Although risks remain, the UK economy appears to be in a better place than is often portrayed, and UK equities continue to look attractive against that backdrop.

Summary

In summary, last week's rebound was welcome but fragile. Relief rallies can be powerful, but they are not the same as a fundamental shift in the outlook. Much of the market's recent optimism is built on the assumption that Trump will back down on tariffs and that the US economy will avoid recession. Both are possible, but neither is guaranteed. Investors would be wise to treat the recent gains with caution and to keep a close eye on developments over the coming weeks. The coming days, with a flurry of earnings reports and a key Federal Reserve meeting, could go a long way in determining whether the market's current optimism is justified or misplaced.

This Week...

Looking to the week ahead, the earnings season moves into high gear with another one hundred and eighty S&P 500 companies set to report. Meta and Amazon will be among the highlights, and their results will provide fresh insight into the health of the consumer and broader corporate sentiment. The tone of management commentary will be fundamental, given the current fragility in business confidence. The Federal Reserve's policy meeting on the 6th and 7th of May will also be closely watched. Whilst no change in rates is expected, the updated Summary of Economic Projections could offer important clues about how officials are thinking about growth, inflation and the future path of interest rates. Markets will be especially sensitive to any signs that the Federal Reserve is becoming more concerned about inflation expectations or more worried about downside risks to growth.



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