The Way We See It

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INSIDE THIS ISSUE

How damaging could Trump 2.0's disruptive reforms be? – U.S. GDP may suffer!

A brief update report which serves to review the recent market development and to offer our outlook for the rest of the year and beyond.

Review of Developments

- Global Economies

On growth dynamics, the first official estimate of the U.S. Q1'25 GDP, based on January data which was affected by bad weather and climate incidents, showed a worryingly high economic contraction of a -2.8% per annum. Consumer spending was weak. Inventories accumulation and CAPEX also slowed down. There is an increasing concern amongst investors that the U.S. economy may fall in a mild recession in the first half of the year.

The European economic bloc is expected to remain mixed (Ukraine war and tariffs are negatives, while rate cuts and disinflation are positives). Japan is projected to continue to grow moderately.

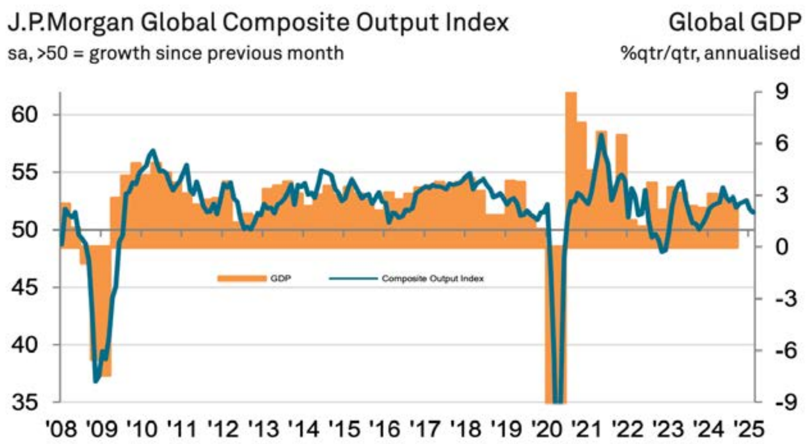
China may take the growth baton this year. In addition to the government's attempt to stabilise the debt crisis in the property sector, recent developments in the AI field (re: DeepSeek and associated technology enterprises) appeared to have sparked a renaissance in the private sector. The government also showed a more harmonious attitude towards the large private conglomerates. In addition, they have pledged to inject more fiscal stimulus to spur consumption. Should these positive trends prevail, there is a good chance of a solid recovery in the domestic economy in China. The export sector, on the other hand, may suffer more as a result of the hikes in tariffs imposed by the U.S. government's trade hawks. All in all, the Chinese economy is likely to stage a bounce versus last year's slow growth.

On the inflation front, in the case of Europe and other OECD countries, headline and core inflation indicators continued to decelerate, thus raising expectations of further rate cuts. In the U.S., the core inflation rate has not managed to fall below the annual 2.5% for some time. In the short-term, inflation data in the U.S. could be boosted by higher tariffs on imported goods. Strong domestic consumption and sticky core services inflation have put the Fed's easing policy on hold.

Short term inflation data in the U.S. could be boosted by higher tariffs.

As a result, the global economy has continued to grow on a sub-par basis, as shown by the JPM global composite PMI chart below.

J.P.Morgan Global Composite PMI™



Source: J.P.Morgan, S&P Global Market Intelligence

Finally, while global geopolitical risks have not gone away, they have definitely improved. The military conflict between Israel versus other warring Arab countries has definitely been cooling down. At the time of writing, the U.S. is attempting to force Ukraine into accepting the terms of a peace deal with Russia. In addition, trade tensions between the U.S. and the rest of the world are intensifying. Threats are being made (or higher tariff hikes have already been imposed) against Mexico, Canada, China, and soon, Europe and other countries which are putting high tariffs against U.S. imports, or which have produced large trade surpluses with the U.S..

- Global Markets

Following a strong performance in the opening month of 2025, the month of February saw profit taking and stop-loss selling in leading U.S. Mega-caps and Magnificent-7 stocks. This dragged the whole U.S. market down. Other overseas equity markets fared a lot better, as investors reduced their exposure to the U.S. in order to diversify elsewhere.

Volatile trading environment remains.

Markets' volatility remained high. Positive factors were partially offset by adverse ones, resulting in a more volatile trading environment.

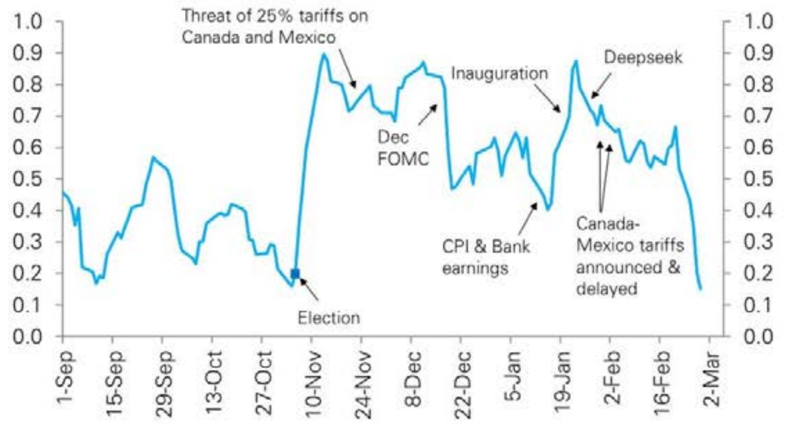
- Positive factors include the continuing AI revolution in the U.S., global upgrades of economic and corporate earnings, hopes for the continuation of the implementation of an easy monetary policy in the U.S. and OECD bloc, and that the big-spending fiscal trend in the U.S. will continue.

- Negative factors firstly include the likely implementation of a series of tariff hikes by the Trump government on Mexico, Canada and China, with the real concern of this spreading to other countries (Europe, Emerging Markets). Moreover, a slightly less but still relatively expensive valuation of U.S. equities (particularly Magnificent-7 and other high-growth winners) demand a better-than-expected delivery of sales and earnings growth, which did not always meet elevated expectations.

- Furthermore, a number of investors remain concerned that equity ownership amongst retail and institutional investors has risen dramatically over the past few months. While the latest data has shown a reduction in this crowded exposure, it begs the question whether most of the good news have been discounted and that the market could still be susceptible to unexpectedly bad news.

Market could be susceptible to unexpected bad news.

Equity positioning slid sharply to near neutral, wiping out the post-election bump



Source: Deutsche Bank Asset Allocation

The global equity universe, in USD terms, fell by 0.69% in February, dragged down by the U.S., which corrected by 1.58%. Global ex-U.S. equities increased in value by 1.77%.

In the Emerging Markets universe, Chinese offshore equities was the star performer, rising by 11.76%, boosted by the DeepSeek's sensational announcement of its very efficient AI platform. Chinese domestic A-shares only rose by 2%. Other EM markets were mixed.

U.S. Treasuries and other domestic and global fixed income markets achieved a solid positive return. Despite concerns over the inflationary consequence of tariff hikes and deportations of low-skilled workers, bonds were the "safe haven" asset class in the month. A combination of weak retail sales data, a collapse in consumer confidence surveys and the potential adverse impact of tariffs on consumer demand raised the probability of a severe slowdown or recession in the US in the first half of the year.

The USD weakened slightly against its trade-weighted index of currencies, as investors began to price in a potential severe slowdown in the U.S. economy in H1, which may force the U.S. Fed to consider cutting rates a few times this year (from one cut just a month ago).

The Commodities complex fell slightly, caused by a decline in energy prices.

Near-term performance of various asset classes

Asset Class	US Equities	Global Equities	Global ex US Equities
Index	MSCI USA	MSCI World	MSCI World ex USD
1 month	-1.58%	-0.69%	1.77%
3 months	-1.16%	0.19%	4.01%
YTD	1.42%	2.84%	6.85%
FY 2024	25.08%	19.19%	5.26%

Asset Class	US Corporate	US Treasury	US Aggregate
Index	Bloomberg US Corporate	Bloomberg US Treasury	Bloomberg US Agg
1 month	2.04%	2.16%	2.20%
3 months	0.47%	1.05%	0.99%
YTD	2.60%	2.68%	2.74%
FY 2024	2.13%	0.58%	1.25%

Asset Class	Global Govt Bonds	Global Aggregate	Global Commodities
Index	Bloomberg Global TSY	Bloomberg Global Agg	CBR
1 month	1.38%	1.43%	-1.02%
3 months	-0.35%	0.01%	5.19%
YTD	1.97%	2.01%	1.72%
FY 2024	-3.58%	-1.69%	12.47%

Asset Class	GEM Equities	Asia ex Japan Equities	China Offshore
Index	MSCI EM	MSCI AC AxJ	MSCI China
1 month	0.50%	1.05%	11.76%
3 months	2.23%	2.02%	15.87%
YTD	2.32%	1.83%	12.83%
FY 2024	8.05%	12.51%	19.67%

Source: GOJI, MSCI, Bloomberg; data as of 28/2/2025

February saw market rotation: U.S. down, RoW up.

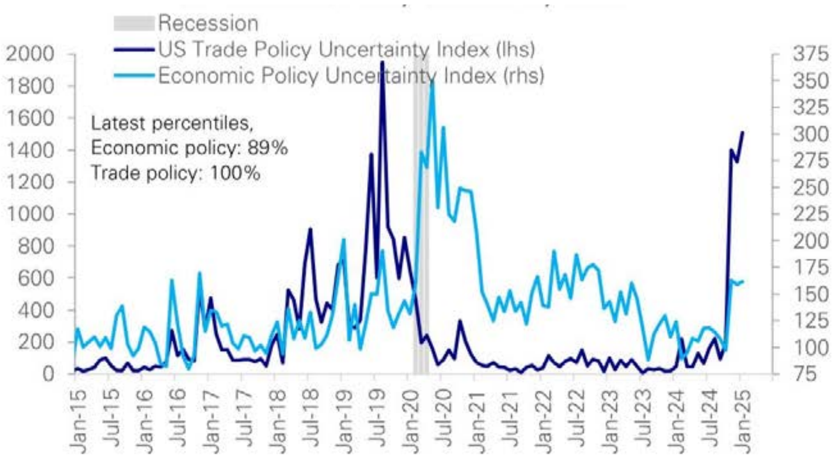
Market Outlook

As our readers and clients are aware, GOJI's Market Outlook is based on our assessment of macro economic developments, forecasts of growth of sales and profits of companies, valuation of key asset classes, and last but not least, investors' positioning and sentiment towards key asset classes, together with their likely resulting flows and the technical charts' trends.

First, the macro economic backdrop in this calendar year is reasonably favourable for economies excluding the U.S.. In the U.S., investors are increasingly concerned that uncertainties relating to the tariffs war, together with the reduction in the migrant workforce and loss of public service jobs, could cause a severe slowdown or recession in H1.

Growing concern on uncertainties in U.S.

U.S. Economic Policy Uncertainty Index



Source: PolicyUncertainty.com, Haver, Deutsche Bank Asset Allocation

We expect that, depending on the intensity of the global tariff trade war and the potential European / China recovery potential, the global GDP growth rate will be at or slightly below their long-term equilibrium. This would allow more rate cuts (even in the U.S.), which will thus make liquidity stay market-friendly.

Second, we expect that while companies will likely, in general, be able to deliver reasonable sales and profit growth, the potential tariff war and U.S. economic slowdown could cause analysts to downgrade earnings growth in the overall U.S. investment universe, and a number of specific global-trade-related sectors.

Third, while bond valuations appear more reasonably priced than their equity counterparts, both asset classes are not outright cheap nor expensive.

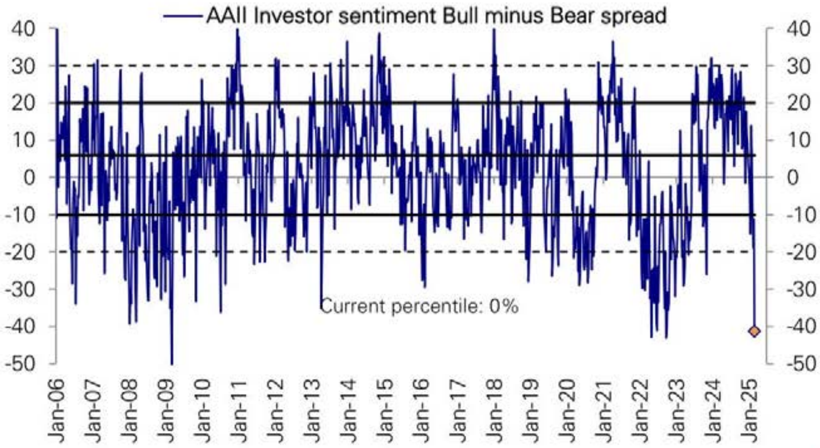
We note that the high valuation of 22X forward P/E on the S&P 500 is not outlandish, as long as their corporates (especially Magnificent-7 and other high-growth stocks) achieve their high sales and profit growth targets, and that the 10-year Treasury Bond yield does not significantly rise above 4.50% p.a..

Current bond rates at 4.20% p.a. appear to have priced in quite a lot of economic slowdown news in the U.S..

Fourth, the latest data on the equity positioning of Discretionary/Fundamental and Systematic investors in February showed that while both types of investors significantly reduced their exposure, they still hold a moderately higher than average exposure to U.S. Equities, based on the past decade.

Long-only investors have significantly reduced their equity exposure.

Investor bull minus bear spread

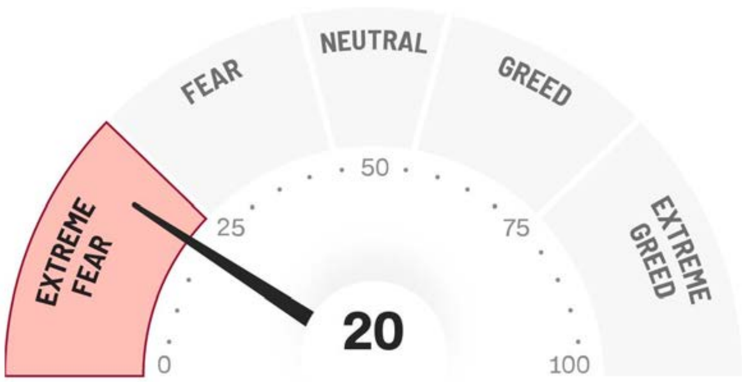


Source: Barron's, Haver Analytics, Deutsche Bank Asset Allocation

In the month, traders and investors' sentiment weakened significantly, oscillating between Fear and Extreme Fear.

Sentiment weakened significantly.

Fear & Greed Index
- What emotion is driving the market now?



Source: CNN Business
Last update February 28 at 7:00:00 PM ET

Short-term Technical Analysis

Finally, a quick assessment of U.S. and global technical charts suggests that the world leading equity indices, Dow Jones Industrials and S&P 500, remain in a long-term bull market, supported by the Golden Cross which was formed in October / November 2023. However, in the shorter-term, the above indices have been weakening and are now situated very close to the crucial 200 day moving average line.

S&P 500 Stock Price Index

Source: MarketWatch.com

The latest Investors' Positioning chart shows that both Discretionary / Fundamental and Algo-driven Systematics investors have fairly substantially reduced their equity exposure following Trump's tariff threats. Nevertheless, they remain overweighted in equities relative to past history.

Consolidated Equity Positioning

Source: Deutsche Bank Asset Allocation

Leading indices are very close to the crucial 200 day moving average.

The Way We See It
- Global Markets and Investment Thematics

At GOJI, we advocate a two-pronged strategy to invest in risk assets.

While our shorter-term tactical (3-6 months) and long-term strategic (1-2 years) views may differ substantially, since the end of November 2024, we have been advocating a risk-adjusted stance towards equities. In other words, we suggested to reduce any overweight in expensive and popular hot stocks and to adopt an overall Risk-Neutral stance in a multi-asset portfolio.

Long-term Risk-Neutral Strategy Rationale:

As outlined in our Global Investment Outlook for 2025, and our recent monthly reports, it is our belief that both fundamental and quant-driven investors have priced in, positioned for and have been prepared to pay up for a best-case scenario of a pro-growth and pro-equities/-crypto investment scenario under Trump 2.0.

GOJI's LT view remains: neutral to risk assets, with a modest u/w to expensive risky high growth assets

A Goldilocks scenario, but with relatively expensive equity valuations in a still-rising bond yield environment. Hence our hesitation to be overweight equities from a long-term strategic viewpoint.

Thus, our long-term strategy recommendation continues to advocate to hold a neutral exposure to risk assets, with a modest underweight exposure to expensive risky growth assets, and overweight cash and less volatile quality assets.

However, as the U.S. stock market is out of favour n the short-term, should it fall too dramatically in coming months, this could offer long-term investors an opportunity to gradually accumulate solid quality US growth stocks at a reasonable price.

Risk-Neutral Tactical Rationale:

In early August, we took advantage of the massive fall of risky assets (caused by factors which are well known to all by now - please refer to GOJI's

September issue), to recommend to our clients to buy them, and build a moderate overweight exposure in U.S. and global equities.

Our tactical bullish view then changed in our November 2024 report, advocating a Risk-Neutral stance. We maintain this view for now.

Postscripts

This month's Special Section is focused on the discussion of the likelihood of a recession scenario occurring in the U.S., in the coming six months.

Special Section: U.S. Recession in H1?

As we argued in last month's GOJI newsletter:

> *"in an all-out tariff war, there is no doubt whatsoever that both the U.S. and the world will suffer from both higher prices and a collapse in the volume of exports and imports. A global recession with high inflation could develop, which is worse than a stagflation scenario.*
>
> *Experienced economists would use the 1930s experience of an aggressive tariff war to paint a very gloomy picture of how the latter contributed to a worsening the global recession and pushed it into a depression.*
>
> *Hence, an aggressive tit-for-tat tariff war could result in a worst case scenario of lower GDP and higher inflation in the short-term. This could ultimately end up with a recession, with deflationary risks.*
>
> *Stock markets are most likely to lose between 20-30% of their value in an aggressive tariff war. USD cash and Gold are the sole assets which are most likely to win."*

That was what we wrote last month.

Since then, the "U.S. recession" scenario is fast becoming a more popular topic of discussion amongst investors. Will it happen? Well, the world-famous Atlanta Federal Reserve is forecasting an annualised -2.8% fall in the U.S. GDP data based on actual U.S. macro-economic data releases, year to date. This suggests that unless the forthcoming growth-related data were to improve soon, a recessionary environment in the U.S. is already here!

While we do not claim to have clever macroeconomic or sophisticated AI economic models to forecast the next few months' data. What we can be more certain of is that, should the tariff uncertainties spread even more broadly and deeply in the psyche of U.S. consumers and corporates, the latter will likely reduce spending. This will increase the probability of the recession scenario.

Therefore, given the latest abrupt daily changes in the tariff policy narratives of Mr. Trump and his senior Cabinet ministers, we believe that one has to believe that, unless other factors in the U.S. economy are quite positive, the probability to a poor growth occurrence in Q1 could rise further. Against that, it may be more sensible to wait for further monthly data to gauge whether the weak January data was caused by weather and climate effects.

Concluding Remarks

In brief, it is our humble opinion that Mr. Trump's strong focus on imposing high tariffs against trading partners, together with deportation of illegal migrant and the on-going reduction of public service jobs (via DOGE), could push the U.S. economy into a mild recession in H1. The market has already started to price this in.

Having stated the above, should the U.S. stock market fall to relatively cheap valuation levels and investors' positioning become too low, we may look to raise the equity exposure from Neutral back to Overweight, adding back the U.S. exposure.

As market sentiment has turned very bearish and investors have cut back significantly on their equity exposure, we are looking to tactically accumulate stocks on weakness.

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