Macro Monthly

Economic insights and asset class views

UBS Asset Management | February 2025

For global professional / qualified / institutional clients and investors

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Navigating tariffs

Highlights

- We remain overweight stocks and bonds based on healthy earnings, solid growth, disinflation, and central bank easing
- Still, tariff risk is real and must be addressed in a balanced portfolio
- Shifting duration exposure from the US to non-US bond markets can help address inflation risks
- We prefer US equities, long USD and JPY vs. EUR and CNH, as well as long gold to help mitigate tariff risks.

We reiterate our positive view on stocks and bonds. Earnings are coming in healthily, growth is solid, inflation is still trending lower, and global central banks continue to ease policy. We like to keep it simple.

But clearly the noise level has increased. The scale of tariffs President Trump announced last week would have been over four times the size of those seen in his first term, with meaningful effects on the US and global economy if sustained. Fortunately, the tariffs on Canada and Mexico were postponed and, while 10% tariffs on China have been implemented, they are no more than investors were generally expecting (and may be removed after a conversation between Presidents Trump and Xi).

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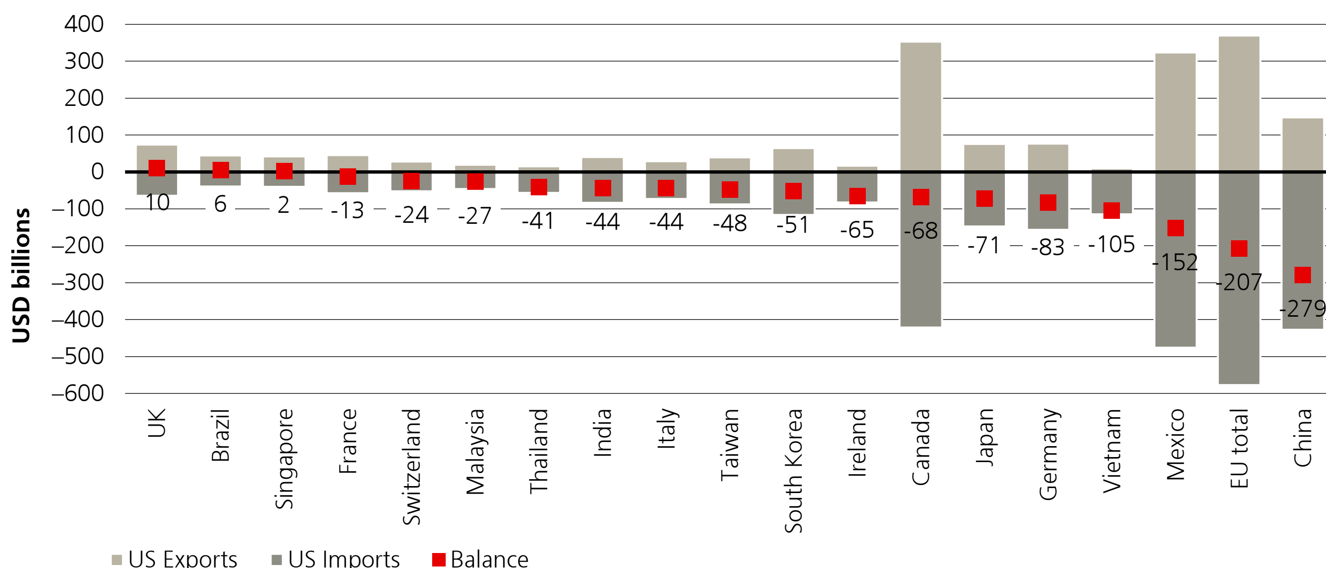
Tariffs were always going to be on the agenda for President Trump, and he favors using them as leverage to achieve non-economic objectives (as in this case, where fentanyl and illegal immigration are in focus), as well as to address perceived economic unfairness (as in the China trade war). That Canada and Mexico were able to postpone tariffs with rather minor gestures, as well as Colombia on an immigration controversy a week earlier, suggests the non-economic objectives may be easier to address.

The issue of 'trade fairness' will be more difficult to remedy quickly, presenting a greater risk for the EU and China. Indeed, President Trump has been particularly vocal about tariffs on Europe of late, and given the challenge of getting 27 member states to negotiate as one unit, the region does appear uniquely vulnerable. The Trump administration will also unveil a more formal global trade approach in the America First Trade Policy review due on April 1. So despite the recent respite, investors must remain focused on tariff risk.

Exhibit 1: President Trump looks set to turn his attention to the EU trade relationship

US trade relationships, USD billions



Source: IMF Direction of Trade, UBS Asset Management. Data as of 2023.

Economic risks of tariffs

Tariffs are difficult for investors to price because even when they are 'known,' the magnitude of economic outcomes is highly uncertain. Growth and inflation impacts depend on several factors, including trade elasticity, the ability of businesses to pass on higher costs, supply-chain integration and currency effects. It is also difficult to quantify indirect effects, such as business uncertainty which may ultimately weigh on investment and employment decisions.

In terms of growth, the US is less affected than its largest trade partners due to its trade deficit, and linking tariff revenue to fiscal spending could mitigate negative effects. However, inflation risks are higher for the US due to increased import prices and a stronger cyclical position compared to the rest of the world.

The Fed's reaction function is also uncertain. Theoretically inflation from tariffs is akin to a regulated price increase, and should fade over the following year. This speaks to the Fed looking through the price effect, especially given downside risks tariffs pose to growth. But if tariff threats continue, then inflation expectations could become unanchored, which could force the Fed into a more hawkish stance. Tariffs thus raise the risk of a higher stock-bond correlation, with rising inflation risk premia undermining bonds and stocks together.

Navigating tariffs

So despite our effort to 'keep it simple,' the reality is more complicated. We do maintain our current pro-risk stance based on underlying fundamentals, but have positioned our broader portfolios in ways to help mitigate tariff risk. First, we maintain a preference for US equities despite elevated valuations – we would like to have more clarity on Trump's tariff policy this spring before diving more aggressively into cheaper international markets.

In fixed income, we have shifted some of our duration preference from the US into non-US bond markets. Since tariffs are likely to have a larger inflation impact in the US and a larger (negative) growth impact in tariffed countries, we prefer to take our duration risk in those trade-sensitive countries. If Trump hits Europe with aggressive tariffs, then bunds are more likely to cushion equity market drawdowns than Treasuries.

Our overall USD view is fairly neutral, but we do have underweights in the EUR and CNH with Europe and China in the crosshairs. Finally, we continue to favor exposure to gold. In addition to ongoing structural EM central bank buying, gold should perform well in an environment of broader policy uncertainty.

Asset class views

The chart below shows the views of our Asset Allocation team on overall asset class attractiveness as of 5 February 2025. The colored circles provide our overall signal for global equities, rates, and credit. The rest of the ratings pertain to the relative attractiveness of certain regions within the asset classes of equities, bonds, credit and currencies. Because the Asset Class Views table does not include all asset classes, the net overall signal may be somewhat negative or positive.

	Underweight			Overweight		
Global Equities				●		Resilient growth and continued disinflation creates a supportive backdrop for equities. Earnings growth argues for more upside, despite elevated valuations. High market concentration in the US is a risk.
US				●		We expect US equities to benefit from strong earnings, resilient economic growth, and potential for deregulation/tax cuts. The main headwinds are increased concentration risk and USD strength.
Europe			→			The risk of US tariffs has increased and tariffs would impact Europe's fragile growth outlook. On the positive side, earnings revisions have turned higher from a low level and the ECB has continued to cut rates.
Japan			●			We are neutral on Japanese equities as ongoing corporate reform, solid earnings, and higher nominal growth is countered by BoJ tightening.
Emerging Markets			●			China's policy pivot and tech advancements are supportive, but trade tensions with the US, and USD strength are headwinds.
Global Government Bonds				●		We continue to think inflation will decelerate this year, supporting the global easing cycle (ex. Japan). Valuations in most DM rates markets remain attractive with rates still broadly restrictive.
US Treasuries				●		We continue to expect underlying inflation to moderate. Large persistent fiscal deficits present a risk to long term yields, but the new administration has shown sensitivity to spending so far.
Bunds				●		Improved valuation, weak growth, slowing inflation and risk of tariffs make us more positive on bunds.
Gilts			●			Large budget deficit with more near-term fiscal spending offsets cheap valuations.
JGBs		●				Wages and underlying inflation are accelerating while market is pricing in too accommodative policy.
Swiss		●				Valuations are historically expensive; substantial further easing already priced for SNB.
Global Credit			●			Credit spreads remain at tight levels; however, given reduced recession risk, we look for positive total returns in US high yield. Elsewhere, we think EUR and Asia HY offer the best carry opportunities.
Investment Grade Credit			●			Investors keep looking for income opportunities in credit, especially as cash becomes gradually less attractive. That said valuations are expensive, and we expect returns to be driven by carry and duration.
High Yield Credit				→		Decent credit quality and the supportive macro backdrop justify tight spreads, but compensation for downside risks is modest. HY bonds in Europe and Asia offer more attractive valuations and carry.
EM Debt Hard Currency			●			Many distressed EM issuers managed a restructuring and important reforms in 2024, clearing the way for lower default risk. Valuations are relatively more attractive than those of DM, but a strong USD is a risk.
FX						
USD				●		We have a slight USD bullish bias given positive yield differentials and to protect against potential tariff risk – though we do see two-way risks as positioning is long USD and tariffs may not be as large as feared.
EUR		●				We are bearish EUR given rate differentials and increased tariff risks, though valuations are attractive.
JPY				●		BoJ rate hikes, cheap valuations, and protective properties make us favor JPY vs. EUR and CNH.
CHF		●				We are negative CHF as we think the SNB will need to cut rates more, while valuations are expensive.
EM FX			●			Overweight ZAR and TRY given carry and a positive policy framework. Underweight CNH on tariff risk.
Commodities			●			We remain positive on gold as an attractive diversifier, with positive demand dynamics from global central banks. We think Brent will remain in a USD 70-80 range.

Source: UBS Asset Management Investment Solutions Macro Asset Allocation Strategy team as of 5 February 2025. Views are provided on the basis of a 3-12 month investment horizon, are not necessarily reflective of actual portfolio positioning and are subject to change.

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