Macro Monthly

Economic insights and asset class views

UBS Asset Management | April 2025
For global professional / qualified / institutional clients and investors

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Trump has constraints

Highlights

- Amid some dramatic swings in economic policy, we are encouraged that Trump seems to be increasingly aware of and reactive to his constraints
- Recent de-escalations on trade and Fed Chair Powell show sensitivity to the bond market and the potential for damaging economic and political outcomes
- At the same time, a good deal of damage has already been done to the economy, and markets will have to weigh near-term downgrades with a better policy outlook
- We look to fade extreme optimism or pessimism in risk assets, focusing on high quality equities and bonds while [playing for] further USD weakness.

April has been a month of extremes, but it is in extreme scenarios that we are learning what limitations Trump faces in his bid to reshape the US domestically, and in its relationship with the rest of the world. We think these constraints provide the market with some reassurance that the most negative tail-scenarios can be avoided, even though the economic outlook is set to deteriorate in coming months.

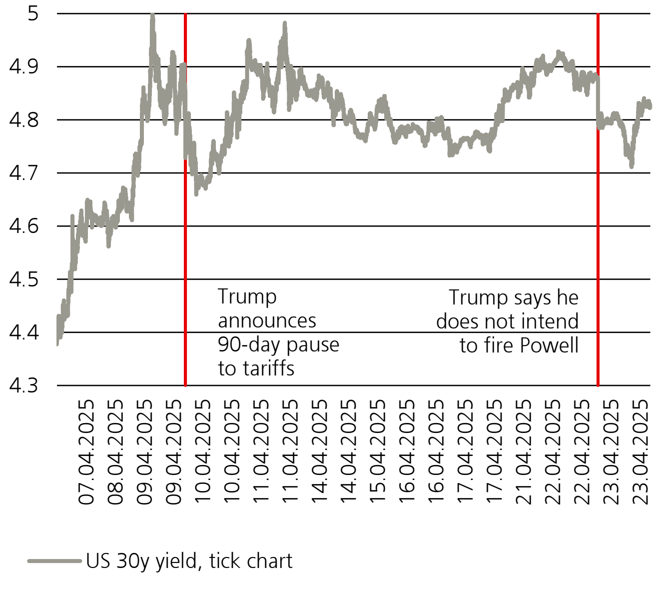
'The bond market is very tricky'

The bond market has been a preeminent constraint on Trump, offering an immediate and unbiased assessment on his policy proposals. When the Treasury curve bear steepens – driven by long-end bond yields rising, US equities falling, and the USD weakening, all together – it is a sign that markets are rejecting the direction of US policy.

A disorderly rise in long-end bond yields is disconcerting as it raises government refinancing costs, leads to higher borrowing rates for US households and businesses, and shakes investor confidence in the traditional hedging properties of US Treasuries. This confidence is vital for market health, as US Treasuries are the basis for the discount rate for global assets and act as key collateral for the global financial system.

On two occasions, we have seen policy U-turns following sharp rises in long-end yields. First on April 9, Trump postponed reciprocal tariffs by 90-days, acknowledging on the same day that "the bond market is very tricky." Second, on April 22, Trump made it clear that he had no intention to fire Fed Chairman Powell. These episodes restored Treasury market function and reassured us that there are constraints on Trump, making worst case outcomes related to tariffs and the Fed chair less likely.

Exhibit 1: Rises in long-end yields have preceded policy U-turns



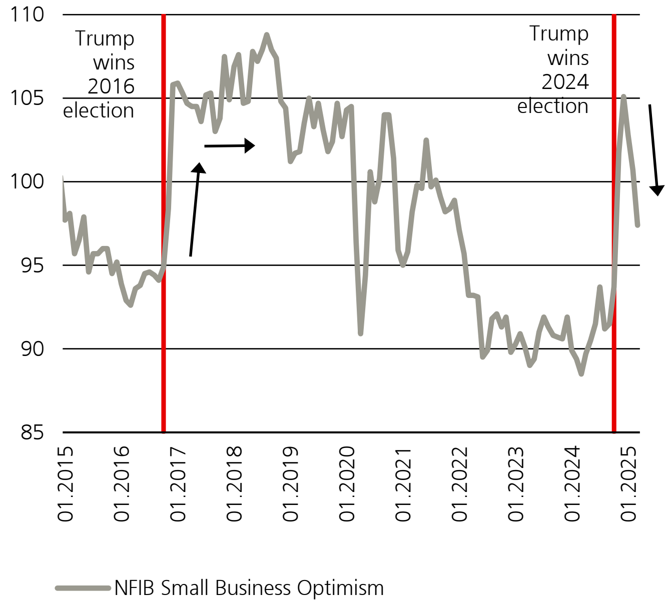
Source: UBS Asset Management, Bloomberg. Data as of April 2025.

The politics of stagflationary policies

Another constraint on Trump is the political economy. While Trump does see his re-election as an opportunity to reshape the global trade landscape and re-shore manufacturing, his agenda is not immune from serious near-term economic and political concerns. Trump's support among Republicans has been resilient, but cracks are starting to form, and this is before tariffs have started to meaningfully impact the economy.

Respondents of the NFIB small business optimism survey viewed Trump as a strong positive for the economy both times he was elected, which implies a Republican lean among those surveyed. In 2016, the election optimism was sustained through Trump's first-term until the outbreak of COVID-19. This time, optimism has already turned lower in response to Trump's policies, with an eleven percentage point drop in the number of respondents who view the economic outlook as positive for the next three months.

Exhibit 2: Small business owners are turning negative on the economy

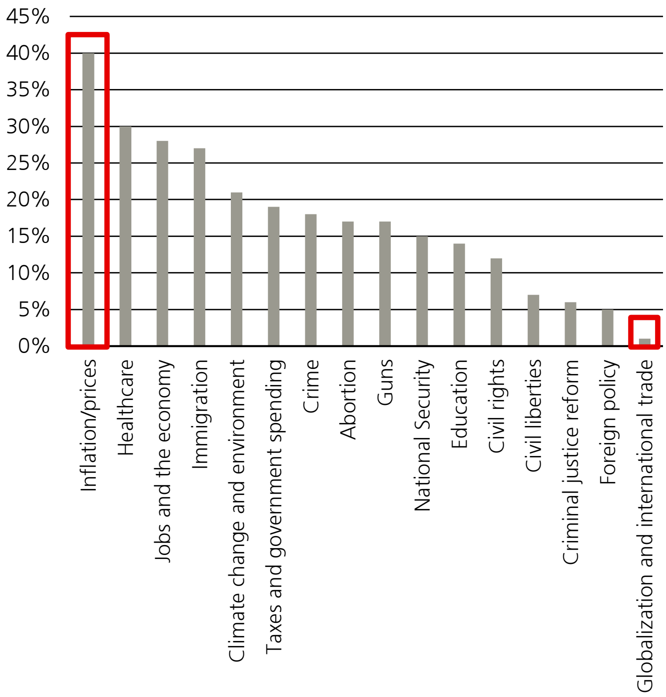


Source: UBS Asset Management, Marcobond. Data as of April 2025.

Many small businesses are particularly vulnerable to the US-China tariffs. Thousands depend on imports from China and do not have the margin space to pay 145% tariffs, nor the flexibility to immediately shift their supply chains overnight. With US-China shipments collapsing under the weight of the tariffs and inventories running low, thousands of small businesses may be forced to close and lay-off workers. Small businesses, or companies with less than 500 employees, make up more than 80 percent of US private employment.

Based on pre-election polls, the most important issues to voters were the cost of living and overall health of the economy (along with immigration). If Trump's tariffs are sustained, UBS economists project monthly core inflation prints to start annualizing above 7 percent in the late summer months. With CEOs from Walmart, Target and Home Depot warning the President there could start to be 'empty shelves' within weeks, it's no wonder he and Scott Bessent have called the tariffs 'unsustainable' and used de-escalatory language. With China in no apparent rush to negotiate, President Trump will likely face a very uncomfortable economic and presumably political environment unless he scales back on tariffs meaningfully. We think he will.

Exhibit 3: Voters care about inflation. They don't care about tariffs.



Source: BCA, Cato Institute 2024 Globalization and Trade National Survey. UBS Asset Management. Data as of November 2024.

Squaring the circle

Even if President Trump scales back tariffs dramatically, it is clear the US economy still faces a sharp slowdown. Business sentiment has collapsed, suggesting that investment is likely to be curtailed. Real incomes are slowing, which will weigh on consumption. And mortgage rates remain too high for the housing market.

For markets, how does one square an anticipated de-escalation of trade policy with an imminent slowdown in the economy? Can risk assets 'look through' a few quarters of weaker growth and earnings if the direction of travel is towards less damaging economic policies?

We feel comfortable saying that the anticipated shift in policies will be enough to avoid worst case market outcomes. At the same time, markets don't seem to be pricing much deterioration in earnings and multiples associated with impending downside risks to the economy, particularly in an environment where monetary policy may be constrained due to elevated inflation and fiscal space is limited.

Asset allocation

So we expect risk assets to be choppy in a wide range, and prefer relative value positions to big directional bets, especially in an environment when markets can be turned on their head by a tweet. We will look to fade sentiment extremes in either direction.

As the economy slows, we favor exposure to the quality factor, both inside and outside the US. We also like high quality bonds, particularly outside the US and closer to the five year point of the curve. In foreign exchange, we see room for further USD weakness over the course of the year, as global portfolios look to scale back on exposures that have become heavily weighted towards the US. Despite its sharp gains, gold remains a helpful diversifier for stagflationary economic outcomes and broader policy uncertainty.

Asset class views

The chart below shows the views of our Asset Allocation team on overall asset class attractiveness as of 28 April 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			←			We are neutral equities and see better risk-reward in relative value, rather than large directional bets given the volatile market environment. We think growth faces a deceleration on the back of heightened policy uncertainty and tariffs. Regionally, we are overweight Swiss and Japanese equities, and underweight Australian equities. On a sector basis, we prefer quality.
US			●			Downside risk to US equities have increased from a narrowing US growth advantage, US policy uncertainty, and concentration in tech. Still, we like to maintain exposure to high quality US stocks with strong earnings. USD weakness is also more supportive.
Europe			●			European equities may be supported from ECB cuts, real income growth, and German fiscal spending. We maintain an overweight on European banks. The main risk stems from excessive EUR strength and a weakening in global trade growth.
Japan				→		Japan has seen better nominal GDP growth and improved corporate governance. Japan is also one of the first countries in line for trade negotiation with the US. As the JPY may continue to strengthen, we express our Japan overweight in unhedged terms.
Emerging Markets			●			China's recent tech advancements in AI may be overshadowed by high tariff rates between the US and China, and weaker global trade growth may weigh on broader EM.
Global Government Bonds				●		We are overweight global duration as we expect inflation to slow (outside of the US) and growth to weaken. Short-tenor bonds offer protection against risk assets should downside risks to growth materialize as central banks have room for additional cuts.
US Treasuries			●			We are neutral on US duration as Treasuries face volatility from policy-induced changes. Tariffs raise near-term inflation risks, and an expansion of the fiscal deficit may raise term premium. In addition, amid US policy changes, US Treasuries have at times had a positive correlation to risk assets. As such, from a portfolio perspective, we think other regions are more attractive.
Bunds			●			We think the front of the German curve could rally on external growth risks, but ultimately think the curve will remain steep, given fiscal stimulus.
Gilts				●		Overweight gilts based upon improved valuations, and as we think the government will avoid a disorderly widening of the deficit.
JGBs		●				Wages and underlying inflation are accelerating while we expect the BoJ to continue tightening policy.
Swiss		●				Valuations are historically expensive, and the SNB is already priced to cut rates to near zero.
Global Credit			●			We think both IG and HY credit spreads do not fully compensate for the challenging macro environment, although all-in yields are attractive. Regionally, we see Asia HY as offering the best carry opportunities.
Investment Grade Credit			●			Given the challenging macro environment, we believe current valuations are not particularly attractive. The direct impact from tariffs should be limited, but more significant impacts will likely arise from second-order effects.
High Yield Credit			●			HY spreads have widened, and there have been large fund outflows, but we do not think HY spreads have yet reached levels that are typically associated with a slower economy, indicating insufficient cushion at these levels. All-in yields are attractive though.
EM Debt Hard Currency			●			We think Asia HY provides the most attractive risk-adjusted carry across global credit segments.
FX						
USD		←				We are bearish the USD as the growth advantage of the US is declining, confidence in the US is being impacted by US policy uncertainty, and as non-USD reserve currencies have proven themselves as a better hedge to equity weakness this year.
EUR				→		We are bullish EUR as it benefits from being the main 'anti-USD', and as the Euro area benefits from increased fiscal spending.
JPY				●		JPY has shown its hedging properties to equities, and we think can still benefit from cheap valuations and BoJ hikes.
CHF		●				We are negative on CHF against other non-USD reserve currencies as we see increased risk of more SNB cuts or FX-interventions.
EM FX			●			EM FX is caught between a weaker growth environment and USD weakness. We remain underweight CNH on tariff risk.
Commodities			●			We remain constructive on gold, even as it reaches new highs, given support from central bank buying amid policy uncertainty. We are neutral on oil due to rising supply and a mixed outlook for global growth, balanced against geopolitical risks.

Source: UBS Asset Management Investment Solutions Macro Asset Allocation Strategy team as of 28 April 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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C-04/2025 M-001205

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