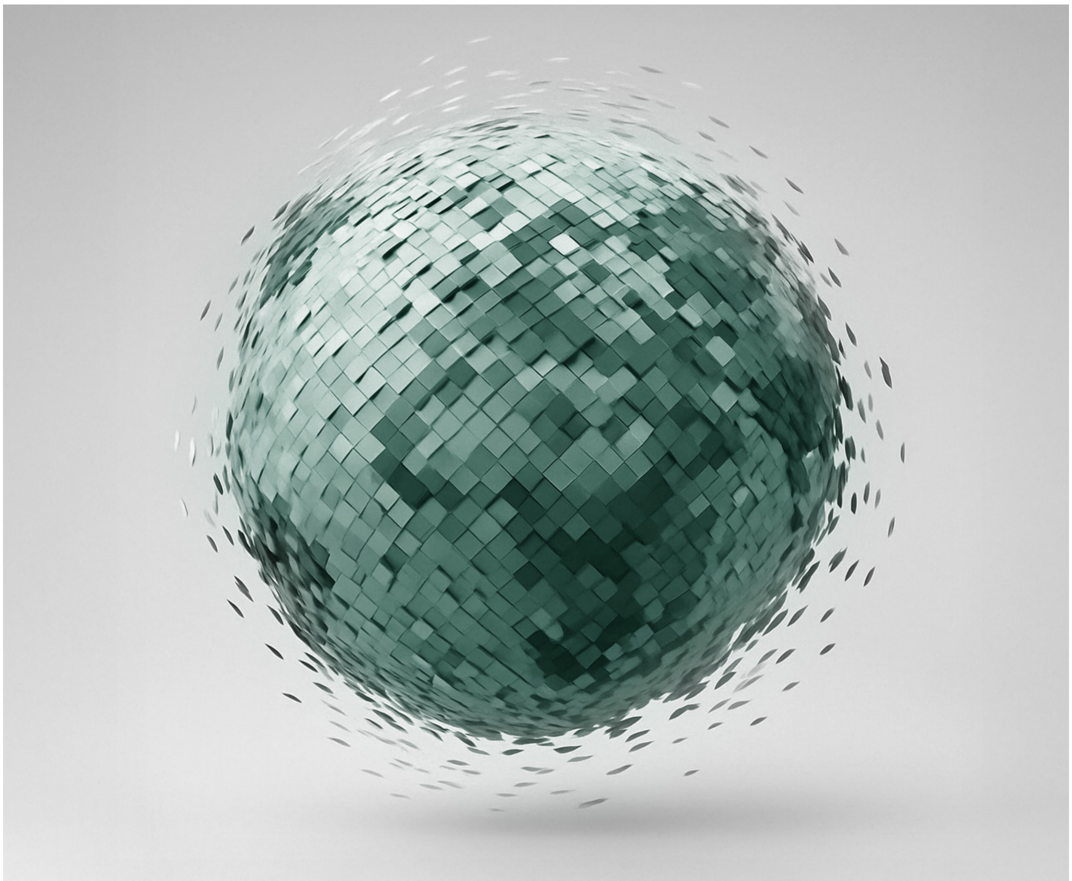
DISRUPTION

Q2 2025



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Dear Reader

US exceptionalism, in other words the remarkable relative performance of the US economy and its financial markets compared with most of the rest of the world in recent years, has been the dominant market narrative for some time. Trump's comprehensive victory initially held the promise, at least in the eyes of parts of the investor community, that this would continue. Since the inauguration, however, perceptions have changed, most dramatically so after the announcement of reciprocal tariffs, now suspended for ninety days, in early April.

How should investors deal with these changed circumstances? Standing still is not an option, but neither is action for the sake of action. Investors should focus on the two key factors guiding most investment decisions: risk appetite and investment horizon. Once adopted, they should stick to their strategy and execute via well-diversified portfolios of quality investments, both in a single and a multi-asset context. After all, it's time in the market that counts, not market timing.

For the second quarter running, we are devoting our Special to the new US president. The recent market turmoil warrants reflection on the goals but also the nature of the Trump presidency, since it represents such a break with US policy since World War II.

To paraphrase the famous Chinese proverb, we continue to live in interesting times. While we could all do with less market drama, we should seize the new uncertainty to deepen our conversations. That is what we are here for. Don't hesitate to reach out to us.

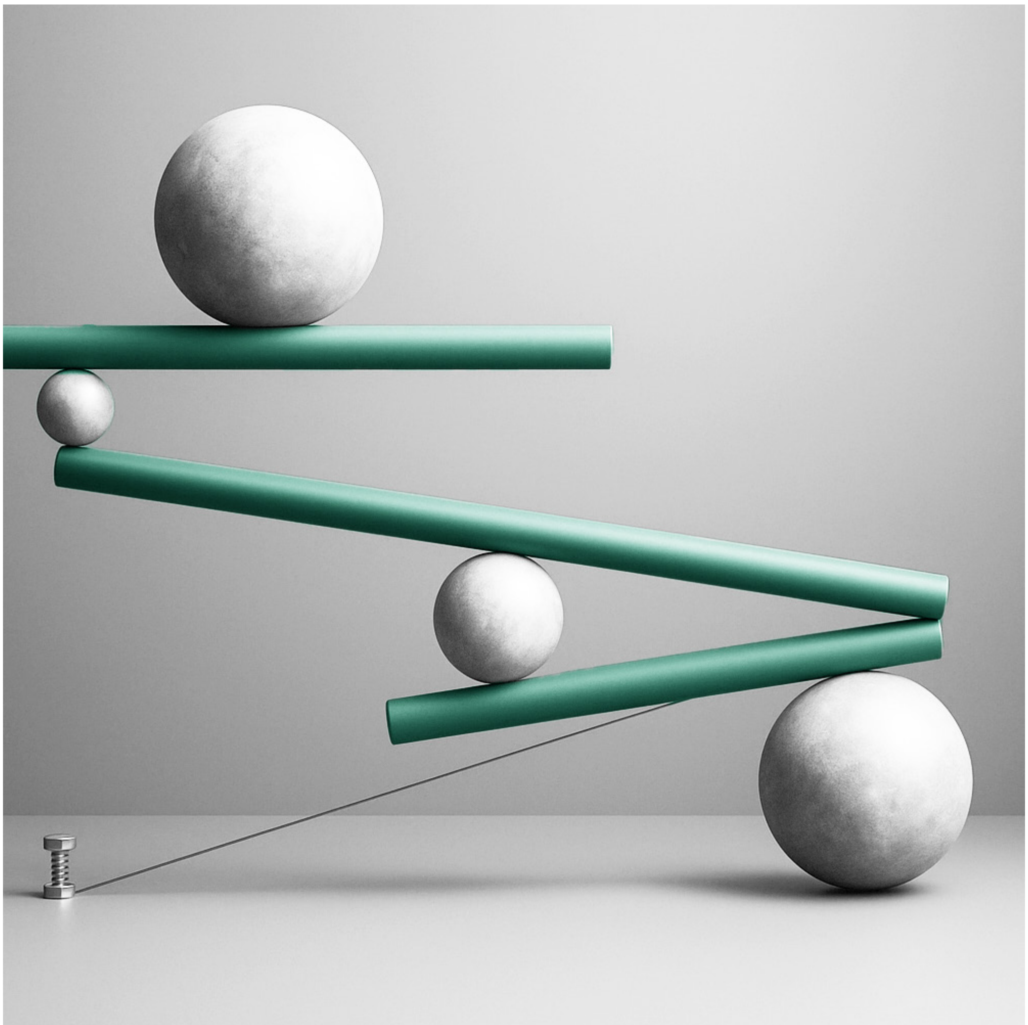
Yours sincerely

Dr. David Wartenweiler, CFA
Chief Investment Officer

THE MACRO BACKDROP

Disruption!

US president Donald Trump kept his word and delivered: all-round disruption, from dismantling government institutions to wrecking the global trade framework. Lower growth, possibly a recession, and higher inflation, at least in the short run, will be the consequence for the US and the world.



Key points

- Trump tariffs wreak havoc on the global economy
- US growth to slow materially
- China to stick to incremental stimulus

Tariffs to slow US growth to a crawl

Trump's reciprocal tariffs – now suspended for ninety days – bear all the hallmarks of self-inflicted damage for the sake of ideological purity. In Trump's world, trade deficits are the result of unfair and discriminatory trade practices. Tariffs, the supposed remedy, however, will only gum up supply chains, raise costs, and diminish US purchasing power, not to mention the standing of the US in the world. As a result, the US consumer is likely to retrench, and growth will suffer. While the price shock caused by tariffs tends to be temporary and not sustained, it will delay a policy response, as the Fed will wait at least until economic data reveals the real damage. We expect this to happen by mid-year. While recession risks have certainly increased, the full extent of the economic impact will depend on second-round effects, including the consequences for the labor market, as well as the timing of other items such as tax cuts that are high on the Trump agenda. The latter entail the risk of exacerbating the already tenuous US fiscal deficit. In an increasingly hostile global environment, foreigners could balk at funding the rising budgetary shortfall, at least at current rates. Savings realized by the Elon Musk-led government efficiency drive ("DOGE") and tariff revenues will not be sufficient to plug the growing fiscal hole.

Recession risks rising in Europe

Just as some timid green shoots were appearing in Europe, Trump hit the EU with a 20% tariff. The economies most exposed to trade are expected to suffer a serious external shock even if the ultimate tariff rates turn out to be lower. Germany, where the outgoing parliament approved a multi-year program of spending on infrastructure and exempted defense spending above 1% of GDP from the notorious deficit brake, may face another year of stagnation. The ECB can step in with monetary support but it can't mend damaged trade links.

China opts for incremental stimulus

Markets have been speculating about a big stimulus program in China for some time. So far, only targeted measures have materialized. This may reflect a more incremental approach than the investment-led programs favored in the past. However, the latest round of US tariffs, to which China has responded in kind, could accelerate the roll-out of such support. As China wants to make itself less vulnerable to external shocks, the focus will shift much more to domestic demand and consumption.

Table 1: Real GDP growth (y/y in %)

	2024F	2025F	2026F	Short-term trend
United States	2.8	1.8	1.9	↘
Eurozone	0.7	0.9	1.2	→
Germany	-0.2	0.2	1.2	↘
United Kingdom	0.8	1.0	1.4	→
Japan	0.1	1.1	0.9	↗
China	5.0	4.5	4.2	↘
India	6.3	6.3	6.5	→
Russia	3.7	1.6	1.4	→
Brazil	3.4	2.0	1.6	↘

Table 2: Consumer price inflation (y/y in %)

	2024F	2025F	2026F	Short-term trend
United States	3.0	3.0	2.7	→
Eurozone	2.4	2.2	1.9	→
Germany	2.5	2.3	2.1	→
United Kingdom	2.5	3.1	2.4	↗
Japan	2.7	2.6	1.9	→
China	0.2	0.5	1.2	↗
India	4.7	4.7	4.2	→
Russia	8.4	9.0	5.5	→
Brazil	4.4	5.4	4.3	↗

Source: Bloomberg, HBZ

INVESTMENT STRATEGY

Adapting to a new world order

The Trump administration has taken the sledgehammer to the global trade and security order. Investors need to come to terms with this new reality, the contours of which are emerging only slowly from under the rubble of the old one.

Key points

- US-centric policies will lead to less US-centric portfolios
- Diversification remains at the core of all investments
- Hard data to reveal the damage in the coming months

New world order, same investment rules

There are years when nothing happens, and then periods when epochal change is compressed into a few weeks or even days. This is what we are currently experiencing as the Trump administration rips apart a global security and trade order built over almost eighty years. It is too early to tell what will follow the current chaos. What is clear to us, however, is that many, if not most, of the tried-and-tested investment rules articulated around the triangle of risk appetite, investment horizon, and diversification will endure. Times like these are, however, a good opportunity for revisiting strategic allocations and tactical biases. One of these biases has been a general propensity to overweight US assets, in particular US equities, in global portfolios. There were good reasons to do so, and many of these investments have paid off handsomely. Now, however, with greater insecurity around the US growth outlook and the country's willingness to engage with the world constructively, the allure of US assets is being challenged. Investors have therefore become open to opportunities elsewhere in the world. The current sea change in world affairs is likely to lead to less US-centric and more globally diversified portfolios, even if the US remains a center of the global financial system and innovation.

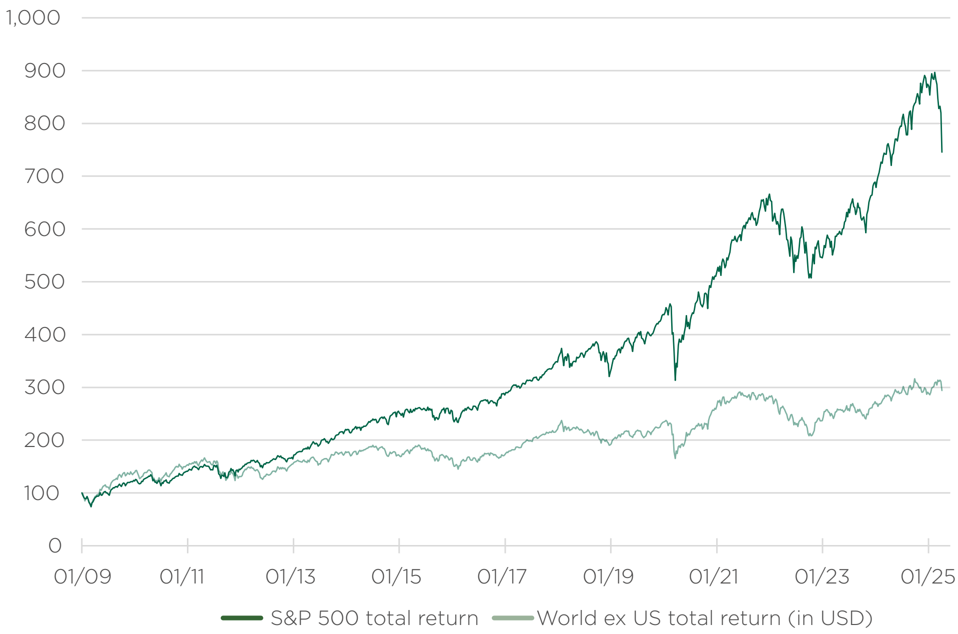
Current positioning

Midway through the past quarter, we started to reduce our allocation to equities and tilt exposure away from the US. We will maintain our equity underweight until uncertainty recedes. On the fixed-income side, we continue to favor defensive exposure to treasuries and investment-grade bonds. We also maintain investments in low-correlation assets such as insurance-linked bonds and, of course, sizeable exposure to gold as a portfolio diversifier and hedge against further USD weakness.

What we're watching

Our current focus is on the consequences for the economy at large and corporations of the economic agenda proposed and being implemented by the US administration. Amid the noise, we are therefore looking for signals from the hard data that will become available over the course of the quarter. At the same time, we are also looking at the geopolitical implications of the changes happening at the level of the global economic and financial system.

Is the outperformance of US equities about to end?



Source: Bloomberg, HBZ

FIXED INCOME

Don’t be a hero

In today’s uncertain global landscape, staying defensive is key. We prefer investment-grade credit for its resilience, attractive yield, and stable returns. The focus has to be on quality, selection, and smart positioning.

Key points

- Favor investment-grade credit amid high uncertainty
- Selective opportunities in strong EM sovereigns and corporates
- Trade tensions and slowing growth warrant cautious positioning

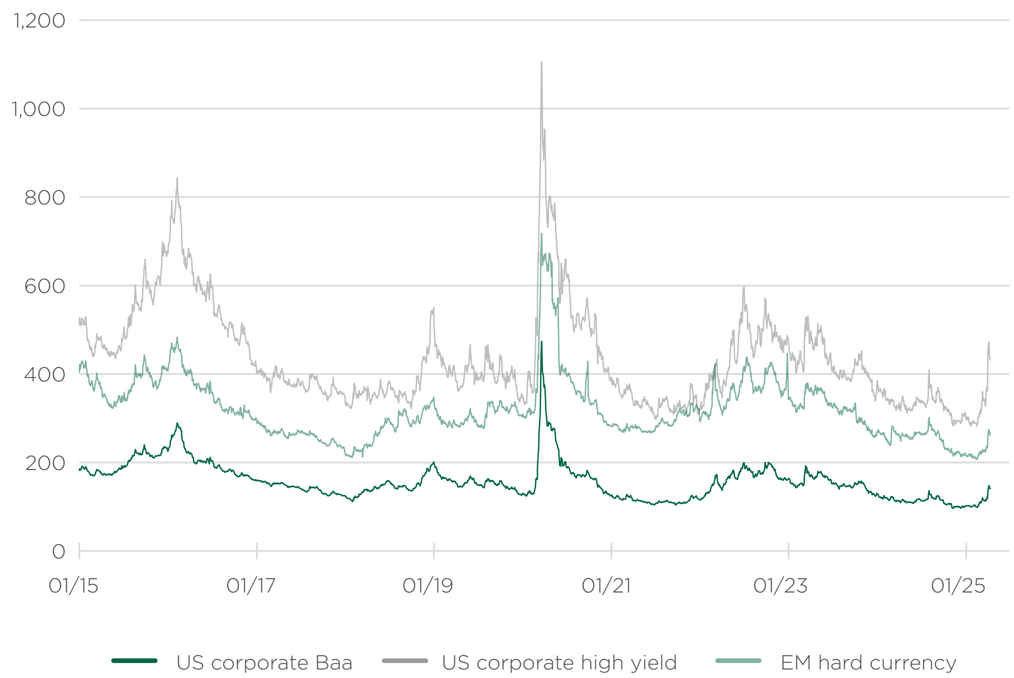
Stick with investment grade

In light of the current economic context, characterized by heightened macroeconomic uncertainty and escalating global trade tensions, a more defensive investment strategy in the fixed-income segment is in order. While credit spreads, particularly in the US, remain tight, it is our view that they do not fully reflect the increasing risk of a material economic slowdown. Fundamentals are weakening and policy visibility remains limited, which challenges the outlook for risk assets. Consequently, we recommend high-quality fixed-income instruments, emphasizing resilience and capital preservation. In the US market, sectors such as financials appear better positioned to withstand the impact of policy shifts and trade disruptions. In Europe, we anticipate a modest widening in credit spreads as external pressures, combined with sluggish domestic growth, exert pressure on the continent. Across both regions, a focus on quality and duration is appropriate. Given the current macroeconomic environment, we believe that investment-grade fixed income still offers attractive yield with a balanced risk-reward profile.

Selection remains key in emerging markets

Emerging market (EM) fixed income continues to offer selective opportunities, though a prudent and differentiated approach remains essential in the current environment. With global growth momentum slowing and heightened trade policy uncertainty, external vulnerabilities across many economies are likely to be tested. In this context, we maintain a cautiously constructive view of EM investment-grade credit, focusing on sovereign and corporate issuers with robust fundamentals, credible policy frameworks, and moderate external financing needs. Relative value can be identified in certain investment-grade credits that continue to trade at attractive spreads compared with developed market peers. EM corporates in sectors such as telecommunications, infrastructure, and metals and mining may also offer opportunities where balance sheets remain resilient and exposure to global demand shifts is manageable. Monetary policy responses will continue to play a critical role, particularly in regions where inflation trends and rate differentials influence capital flows. Overall, disciplined credit selection, diversification, and a focus on quality remain key to navigating this complex investment landscape.

High-yield bonds lead credit spread widening (in bps)



Source: Bloomberg, HBZ

EQUITIES
Navigating choppy waters

The Trump tariff announcements shook global markets, leading to a violent sell-off of equities. In times of heightened market volatility, investors should focus on the long term and stick to their strategic asset allocation.

Key points

- Current bear market is event-driven but at risk of becoming more entrenched
- A structural downturn would represent a long-term headwind for equity markets
- Focus on a diversified portfolio of quality stocks and risk-managed strategies to weather the storm

Entering bear market territory

At the beginning of the second quarter, many equities were on the verge of a bear market. A bear market is generally defined as a drop of 20% or more in the market. While there are different types of bear markets, the current one so far appears to be tariff- and therefore event-driven. Event-driven bear markets, such as the sell-off during the pandemic, are typically rather short-lived and rebound quickly and sharply. At the current stage, this should still be the base case. However, President Trump is arguably playing a very dangerous game, as the event-driven sell-off could turn into a cyclical or, in the worst case, even a structural downturn, if he stays on the current policy path for too long. In a cyclical bear market, the Fed would need to step in and start cutting rates aggressively, which would only be possible if inflation remained under control. In this scenario, a recovery would take significantly longer. If history is any guide, equities could decline up to 30% in a recession and a recovery would take about 18 months on average. In a structural downturn, the US could become globally more isolated as a result of the current policies. Moreover, such a downturn could last for several years, as the reshoring of manufacturing and sustained high tariffs would invariably lead to higher inflation and slower growth. Consumers in particular, the main driver of the US economy, would retrench in such a low-growth environment.

What should equity investors do?

Calling a bottom, especially in the current circumstances and the deafening noise, is extremely difficult. Selling now and getting back into the market at a later stage could lead to selling low and buying high. Investors should therefore remain invested and sail through the eye of the storm. Eventually, some semblance of calm will return. Those who remain invested in well-diversified portfolios consisting mainly of quality stocks should experience less downside while the storm is raging. They will also benefit early from improving market conditions, especially compared with those who engage in the difficult, if not losing, game of market timing. Actively risk-managed strategies can also reduce the downside when markets fall and allow greater participation when markets turn again. The key message is straightforward: Investors should invest for the long term in accordance with their ability and willingness to take risk. And then they should stick to their strategy.

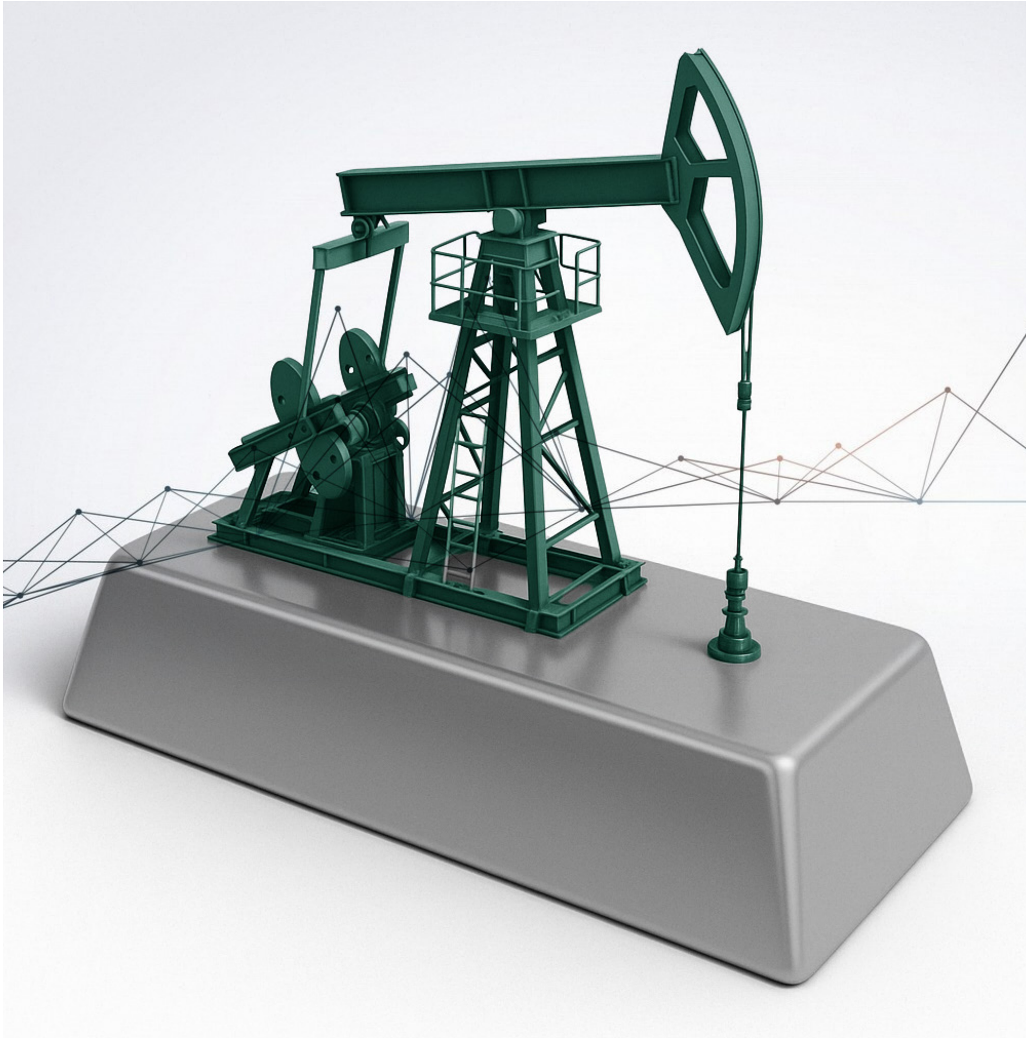
Not all bear markets are created equal

Source: Bloomberg, HBZ

COMMODITIES AND FX

The twilight of the US dollar

For decades, the US dollar reigned supreme as the monetary linchpin of the global economy and the ultimate symbol of US power. Donald Trump's indiscriminate wrecking ball is now actively undermining the currency's unique status. We expect further weakness and no easy transition.



Key points

- USD dominance set to decline in the years ahead
- Euro the only credible competitor
- Gold will remain well bid

Diversifying away from USD

The Trump administration's policy agenda aspires to assert US interests, but its effects may be the opposite. The growing risk to the US dollar's long reign as the global reserve currency is the best case in point. While the greenback has been overvalued by most measures for some time, its dominance has reflected the brute economic strength of the country. To forego the privileges that come with owning the world's reserve currency is an act of recklessness. Only thanks to its currency has the US been able to fund its deficits, and only thanks to the depth of its markets has it been able to dominate global trade flows. There is no easy alternative waiting in the wings, though. The only remotely credible competitor is the euro, as flawed as it may be, the common currency of twenty sovereign states. The Chinese renminbi lacks the full convertibility that a currency needs to aspire to the role of a global reserve asset. The yen, and even more so the British pound, lack market depth and economic strength, not to mention the ability and willingness to project power abroad, to count as valid options. So, what is the conclusion? The USD will see its importance decline, if only slowly, in a fragmented world where trade flows are settled increasingly on bilateral currency terms. Central banks will reduce their allocation to the USD in favor of other convertible currencies and add more gold to their holdings. And finally, portfolio flows, a strong support for the USD during the last few years, will probably reverse, favoring European majors and the Japanese yen.

Commodities battered by trade war

Gold will remain in high demand as the world becomes less USD-centric, and the weakening USD will enhance the metal's status as a quasi-currency hedge. The trajectory for many, if not most other commodities, will be less clear. Crude oil has come under renewed pressure following OPEC+'s decision to increase output to punish non-compliant members and possibly extract concessions from the US administration. As global trade is expected to slow under the impact of US tariffs, demand for oil will remain tepid at best, creating additional downside risks. The same applies to many industrial metals, where demand is likely to soften in a weaker growth environment and amid China's transition to a less investment- and infrastructure-focused growth model.

US wants overvalued USD to weaken

Source: Bloomberg, HBZ

KEY MARKETS
Plenty more to do

As tariffs roil the global economy, our key markets must not turn complacent if they want to stay their course. Pakistan needs to stay firm on fiscal consolidation, the UAE has to further boost its non-oil economy, while the UK must come up with a credible plan to boost growth.

Key points
- External accounts remain pain point for Pakistan
- UAE growth supported by non-oil sector
- UK struggling to emerge from low-growth environment

Pakistan: holding it together

Following a year of economic turnaround, Pakistan is endeavoring to sustain momentum as bumps appear on the horizon. A stable exchange rate and soft oil prices have led to moderation in energy and food prices; however, core inflation showed enough persistence for the State Bank to hold in March after a steep easing spree. With imports ballooning, the current account turned negative once again in the first two months of the calendar year, causing renewed strain on the country's FX reserves. Sustained high remittances of some USD 3bn per month have cushioned the blow somewhat. To unlock savings, the country is renegotiating contracts with independent power producers, which previously enjoyed generous guaranteed returns. Furthermore, lower oil prices have yet to be passed on to retail gas prices or electricity tariffs. The benchmark equity index touched another all-time high in March following a successful first review of the current IMF program, which resulted in a staff-level agreement along with an additional program to build resilience to climate risks, unlocking some USD 1.3bn. The support to reserves gives the country some room for the Eurobond repayment due in September.

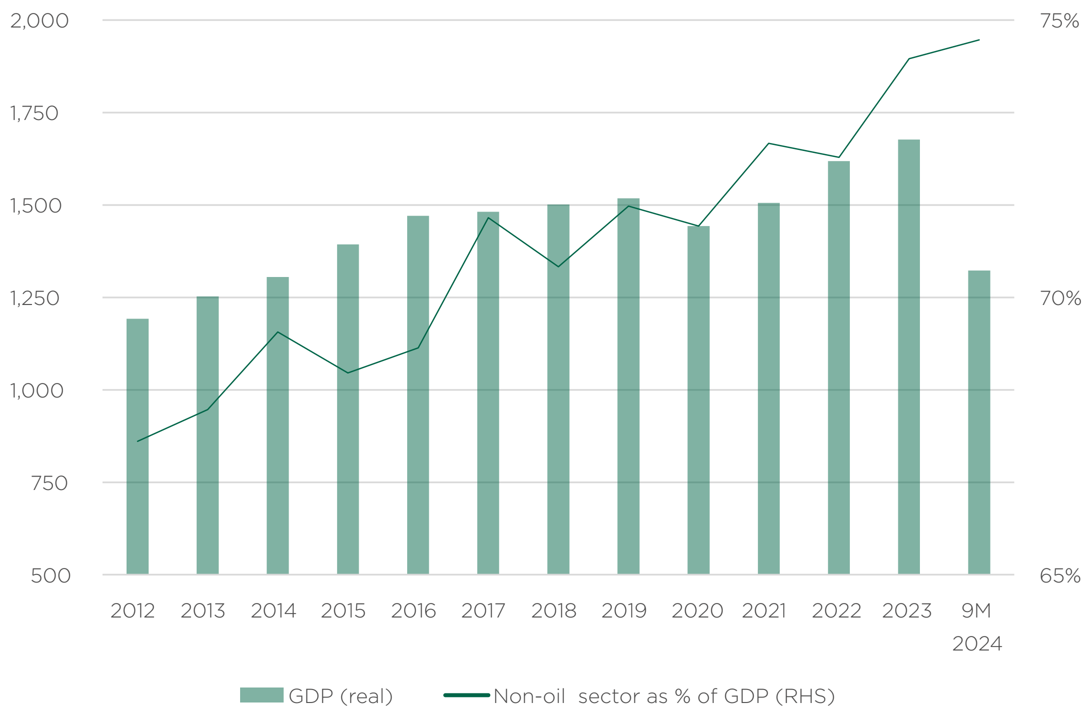
UAE: non-oil economy to the fore

Crude oil has dropped more than 16% so far this year amid global growth concerns, and the OPEC+ decision to roll back voluntary cuts in early April has created downside risks for the Emirates oil sector. At the same time, the non-oil sector is well positioned to raise its contribution to the economy. Dubai, a key pillar, is leading the way with strong numbers from tourism, with visitors up 9% in 2024 and aviation and the hospitality sector booming.

UK: not out of the woods

Following its victory in the elections last year, Labour pledged to reignite growth in the UK. So far, the government has little to show for its efforts, and the country narrowly skirted a contraction late in 2024. With growth trailing forecasts and a surge in borrowing costs, a policy reset seems inevitable, either in the form of spending cut or a breach of the government's fiscal rules. Progress against inflation at least allowed the Bank of England to cut the base rate again in February, and markets are pricing in additional easing as early as May.

UAE's economic transition (in AED bn)



Source: Bloomberg, HBZ

SPECIAL TOPIC
The end of a rule-based world order?

President Trump represents a clear break with the core principles which have underpinned American economic and foreign policy since World War II. Turning the page on a rule-based order, as imperfect as it may have been, creates uncertainty and risks for all economic agents, including investors.

Key points
- America First makes no sense in today's world
- Hyper-personalized politics lead to uncertainty
- Investors may demand higher risk premium on US assets

America First

America has always put itself first. The slogan is therefore redundant at best. What it actually means is that President Trump wants the US to turn its back on the world and return to the early days of the republic, when it was mostly concerned about keeping European powers off the American continent. In today's world and with today's technologies, this seems a poor plan to address the country's many challenges. Of course, it is also a loss for the world, since the planet needs more, not less, cooperation on pressing issues such as climate change and migration.

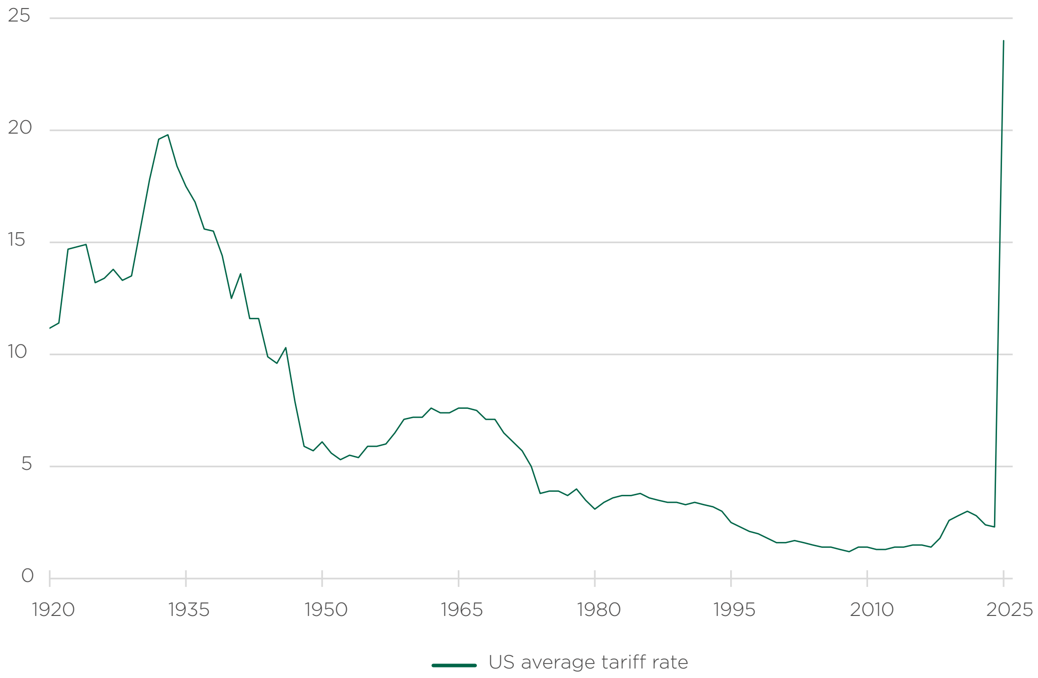
"I am the boss"

Reducing international affairs to highly personalized bilateral relations also brings back the worst elements of the Cold War and earlier periods when great powers (and their closest allies) rode roughshod over smaller nations that got in their way. Moreover, this focus on the personal creates a very unstable market context, as it exposes all dealings to the whims and daily moods of a small number of decision-makers. Such systems also tend to breed corruption and the very unfair practices that the president claims to want to eradicate. Indiscriminate tariffs, just to give one example, lead to the protection of all industries and are often a subsidy to companies that would otherwise not survive in a competitive market. This encourages rent-seeking behavior and rewards low productivity.

Uncertainty is poison

Part of the economic success of the US and its ability to attract capital has rested on a sound legal and institutional framework. Setting up a factory is a multi-year process in most industries. How can the US expect investors to flock to its shores when the rules can change from one day to the next? Potential investors will have to add a risk premium for US-based projects and, by virtue of this, may decide to postpone or altogether refrain from committing capital. The same applies to financial investors. With the Trump administration intent both on weakening the US dollar and lowering taxes, even at the cost of an even higher budget deficit, what level of yield is appropriate on Treasury paper for an investor, let alone for a non-USD investor? If such and similar concerns creep into investment decisions, US assets may suddenly look much less attractive.

The US tariff wall: suspended for ninety days (in %)



Source: Bloomberg, HBZ

MARKET SUMMARY DATA

As of 14 April 2025

Equity indices	Last	-3M %	YTD %	-3Y %
BBG World USD	1,851.6	-4.1	-4.9	24.0
S&P 500	5,363.4	-8.2	-8.8	22.1
EuroStoxx 50	4,895.0	-1.7	0.0	27.2
FTSE 100	8,135.2	-0.8	-0.5	6.8
SMI	11,444.0	-2.2	-1.4	-8.3
Nikkei	33,982.4	-11.7	-14.8	25.1
BBG EM USD	1,183.0	1.1	-1.1	2.8
Sensex 30	75,157.3	-2.0	-3.8	28.8
KSE 100	116,384.5	1.3	1.2	150.4
Hang Seng	21,417.4	11.4	6.8	-0.5
Brazil Bovespa	127,682.4	7.0	6.2	9.9

Bond indices	Last	-3M %	YTD %	-36M %
BBG US Gov	2,327.33	2.6	1.6	1.1
BBG US Corp	3,281.50	1.0	-0.2	4.8
BBG US HY	2,644.96	-1.4	-1.4	15.0
BBG Euro Gov	245.20	1.6	-0.3	-3.8
BBG Euro Corp	257.97	1.0	0.0	4.4
BBG EM Sov	400.49	-0.5	-1.3	10.8
DB EM Local USD	166.16	4.9	5.7	10.9

Currencies vs. USD	Last	-3M %	YTD %	-3Y %
DXY	100.10	-9.1	-8.4	-1.0
EUR/USD	1.14	10.9	10.2	5.5
USD/CHF	0.81	12.1	11.3	15.6
GBP/USD	1.31	8.2	5.3	1.0
USD/JPY	143.54	10.8	10.2	-11.8
AUD/USD	0.63	2.4	2.4	-14.6
USD/CAD	1.39	3.8	4.0	-8.8
USD/ZAR	19.17	0.2	0.1	-22.3
USD/INR	86.70	0.6	-0.5	-11.7
USD/PKR	280.50	-0.8	-0.9	-35.5
Gold oz.	3,237.62	20.9	22.9	63.7

Interest rates	3M interbank %	10Y government %
USD	4.26	4.45
EUR	2.28	2.55
GBP	4.26	4.68
CHF	0.05	0.43
JPY	0.39	1.34
AUD	4.09	4.40
CAD	4.97	3.26
ZAR	7.54	10.92

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