REYL
OVERSEAS
Intesa Sanpaolo Group

STRATEGY OUTLOOK

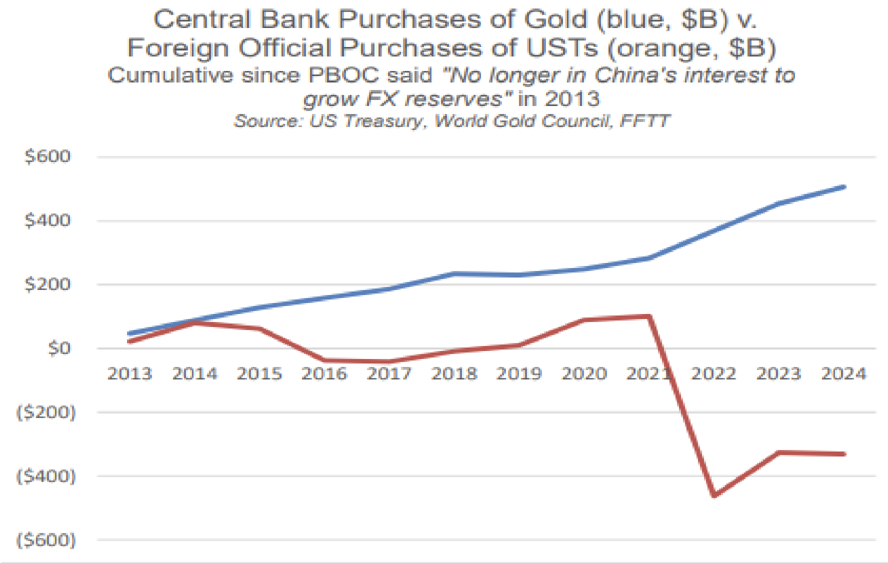
MARCH 2025

Key takeaways-

- Market indigestion in February.
- US economic data weakening.

Volatility and uncertainty hit markets in February reversing some of the prior month's gains. The decline was led by Japanese (-6%) and US stocks (-2%) with clear outperformance from Europe (+2%) and the UK (+1.9%). The 5yr US Treasury fell 30bps as the economic data also weakened on top of a change in sentiment from investors. **Reflecting the move towards safe haven** assets Gold had another good month up 2.1%.

Markets were lacking direction. The evidence for any immediate interest rate cut isn't clear, the short-term, Trump inspired rally, has come and gone and there remains **unanswered questions regarding tariffs, tax, deficits and deregulation**. In the last few years US growth has been propped up by US fiscal spending. With DOGE, and the speculation around it, bold, sweeping cuts are being made which are already proving to be a headwind to the economy. It's unlikely lower growth will trigger any type of recession, however. **The US economy is strong, unemployment is low and household/corporate balance sheets are in good shape. It can absorb quite a few shocks, but headwinds are rising.**

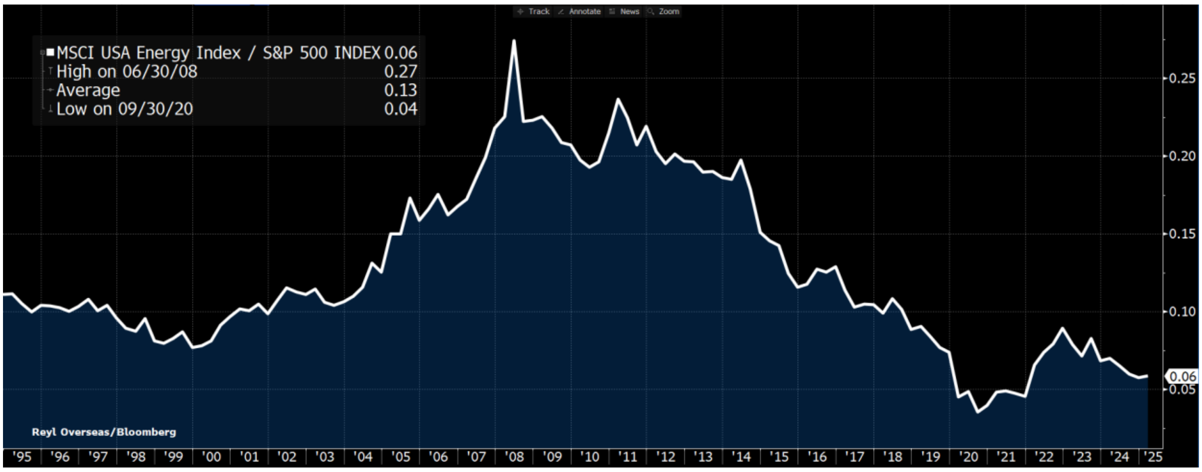


Gold has continued to perform. As the graph highlights global central banks have been continued steady buyers moving increasingly from US Treasuries to Gold. The new US Treasury Secretary Scott Bessent hinted that within the next 12 months the Administration will announce ways to **"monetise the asset side of the US balance sheet for the American people"**. Currently Gold is valued by the Treasury at $42/oz and a re-valuation would see a potential $745bn deposit created. Bessent later denied the possibility and stated that he had no plans to revalue gold but irrespective bold moves like a revaluation are on the table. Other comments he has made imply grand plans for a revamped international monetary system less reliant on the dollar. Expect some kind of bold change, a revaluation in Gold would be disinflationary and bond positive.

Over the month we reduced US equity exposure by around 3% going back into US Treasuries, an asset we haven't held for well over a year. Despite the likelihood of further liquidity, buybacks and solid earnings growth there a few reasons for pessimism. Valuations are high and arguably stretched. Geopolitical tension and uncertainty remain high, investor cash levels are low and sentiment on the US high, longer term population shrinkage is a headwind, deficits and defence will take priority and interest rates are unlikely to be cut. In conclusion it all makes **for a more neutral stance on US stocks rather than a bearish view.**

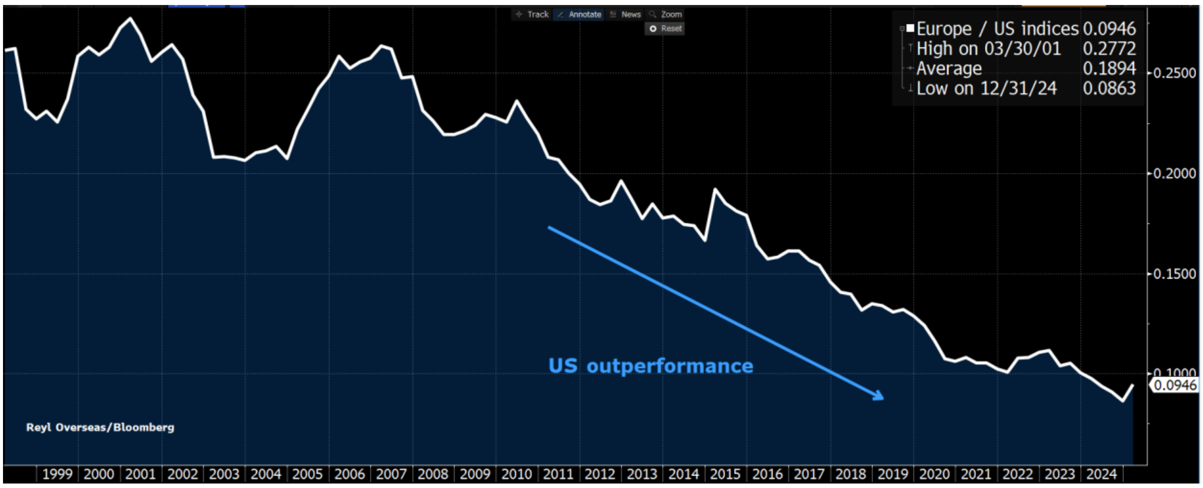
Having said that there is value. The second graph highlights energy stocks as a ratio to the S&P where the sector is as cheap as it's been since 1995. Additionally, traditional value can be found in Emerging markets and Europe.

With so much speculation about tariffs Mario Draghi (former president of the ECB) took the opportunity in the FT (14 Feb) to turn the light away from the US. He has been a lone voice arguing for radical change in Europe. In the article he notes that the EU's high internal barriers and regulatory hurdles are far more damaging than any tariff the US might impose. He cites an IMF report that Europe's internal barriers are equivalent to a tariff of 45% for manufacturing and 110% for services. He also states that trade across EU countries is less than half the level of trade across US states.



The changes required in Europe given the need for consensus seem a long way off. What can transform, particularly Germany, is a deal over Ukraine. The return of Russian gas would literally re-ignite the German economy where there are several cheap energy-sensitive stocks and probably a cheap currency. For example, VW trades at Price/earnings of 4 with a dividend yield of 8% (observation not investment idea). However, the funding demands from the US for massive increases in European defence spending and the rebuilding of Ukraine will require more funding from EU countries.

The third graph highlights the clear, long-term trend of US equity outperformance vs Europe. We may or may not be on the cusp of a change however more evidence is required to believe any type of sustained US underperformance is likely.



Change is afoot with both positive (deregulation) and negative (tariffs) supply shocks possible. However there remains too much debt, a deficit, and a government sector spending too freely. Expect volatility but it's going to be tough for the S&P to repeat the 20% gains of the last 2 years.

We suspect that Gold will, on a relative view, outperform risk assets. Indeed, the portfolios are positioned with overweight positions in Gold and Silver. We will be keen observers of the path of the USD as to when EM can begin to shine, another area we have a small overweight. Any weakness could be a significant tailwind to a variety of cheaper assets.

Part of our focus will be towards technology and the frightening pace of advancement in AI, robotics and potentially quantum computing. That last sentence didn't do either the pace of growth or the spectrum of growth justice. Change is coming fast.

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