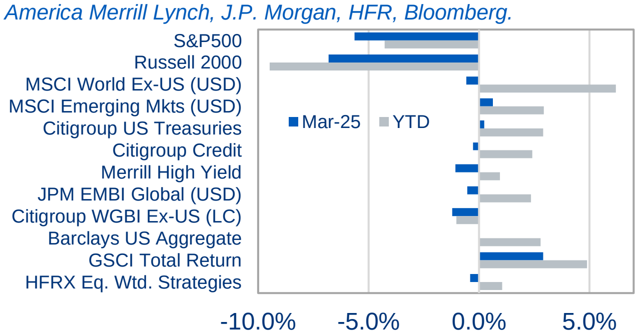
Global Market Review

Policy uncertainty and concern that massive U.S. tariff increases will slow growth and raise prices have dominated markets. Business and consumer sentiment has soured. Firms are deferring hiring and investment. Households expect sharply higher inflation, declining employment opportunities, and a deterioration in their financial condition. The economic disruption of policy uncertainty is mirrored in recent market movements. U.S. equity prices fell in March, compounding February losses. Investment grade and high yield bond prices also declined. The U.S. Treasury yield curve is once again flirting with inversion. Non-U.S. equity markets, especially European equities, performed considerably better than the U.S., despite uncertainty about the impact of increased U.S. tariffs on their exports. The U.S. dollar fell further against major currencies in March. Gold prices, in contrast, soared, surpassing $3,000 per ounce. Oil prices dipped, then recovered. Tariffs pushed steel prices sharply higher.

Performance of Major Market Indices

Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.



U.S. equities lag other markets.

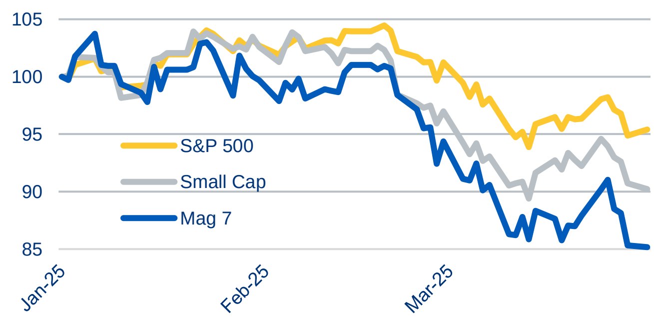
Uncertainty Sends U.S. Equities Lower

The U.S. equity market entered the year buoyed by exuberance but burdened by excess valuation. Despite recent declines, the valuation of the U.S. equity market remains near record levels relative to its own history and that of other markets. High valuations are vulnerable to changing sentiment in the best of times. They are especially at risk when uncertainty is also high. No one can say how tariffs will affect the earnings and stock prices of U.S. firms. Nor is it possible to handicap whether foreigners, who own 25-30% of the U.S. equity market, will continue to favor U.S. assets in the wake of the abrupt about face in U.S. trade, defense, and foreign policies.

So far, the equity market does not appear overly concerned by the potential for instability precipitated by the combination of high valuations and mounting uncertainty. The VIX index (an option-based measure of expected equity market volatility) is trading around its long-term average level. Moreover, after two successive years of returns in excess of 20%, the market has so far given up only a small portion of those outsized gains.

Exhibit 1. Policy Uncertainty Weighs on U.S. Equity Market

Source: Bloomberg. Index January 1, 2025 = 100.



The S&P 500 index fell 5.6% in March, bringing its loss for the first quarter to 4.3%. Mega-cap tech stocks proxied by the Magnificent 7 have led the market lower this year (Exhibit 1). Tesla, hard hit by investor revulsion, plunged 32% in the first quarter. Small-cap stocks have also underperformed the broader market. Growth stocks lagged value in March, losing 8.4% versus value's 2.9% decline. In the first quarter of the year, growth fell 10% while value gained 1.6%.

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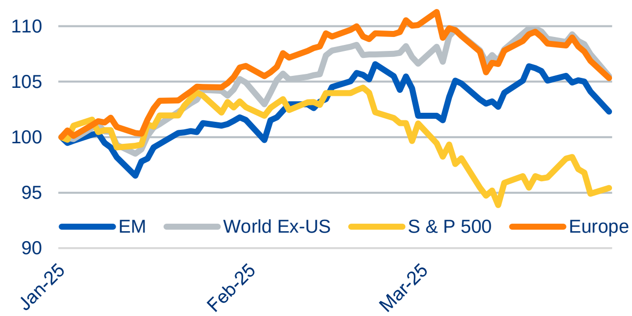
Europe Leads Developed Equity Markets, China Soars

The MSCI World ex-U.S. index of advanced economy stocks fell 0.6% in March, bringing its gain in the first quarter to 6.2%. European markets have performed especially well, despite high energy prices and the threat of tariffs (Exhibit 3). The main drivers of the European market's gains include signs of resurgent European economic growth, the prospect of a massive German fiscal stimulus and higher defense spending across the continent, expectations for further monetary easing by the ECB, greater political stability following the recent election cycle, and a potential reduction in regional conflicts. The U.S. dollar's decline has also boosted the return of European equities to U.S. based investors. Relative valuations continue to heavily favor European equities. Despite the U.S. market's recent decline, stock valuations remain well above historical averages and the valuation gap between the U.S. and European markets is near record levels.

Exhibit 2. European Equity Markets Take the Lead

Source: Bloomberg. Index January 1, 2025 = 100.



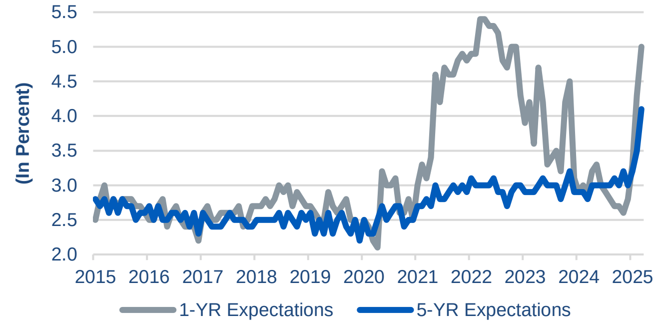
Emerging equities also outperformed the U.S. market in March. They are up 2.9% in the first quarter of the year. Chinese equities, which jumped 11.8% in February, rose a further 2.0% in March to bring their gain so far this year to 15%. The Chinese market's stellar performance reflects strong gains in the tech sector following a breakthrough in AI and EV technology and the prospect of fiscal and monetary stimulus aimed at boosting the broader economy and the share market. Turkish equities and the lira plummeted in March following the arrest of the leader of the opposition to President Erdogan. Autocratic rule and a history of iconoclastic monetary policies are weighing heavily on Turkish markets and its currency.

Inflation Expectations Risk Becoming Unanchored

There are worrisome signs that inflation expectations may be becoming unanchored. In contrast to the 2021-2022 inflation shock, the latest University of Michigan survey of consumer sentiment points to an increase in long-term inflation expectations (Exhibit 3). An instability in long-term inflation expectations is especially risky in the current environment. If sweeping tariffs are imposed, price pressures will inevitably rise. Expectations will determine whether this tariff-induced increase in the price level is a one-off event or the trigger of an inflationary spiral. The latter would greatly complicate the Fed's ability to once again engineer a moderation in price pressures without precipitating a recession.

Exhibit 3. Inflation Expectations Spike

Source: University of Michigan. Expected inflation rate in percent.



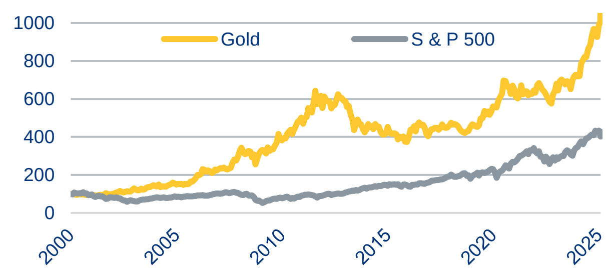
So far, the inflation concerns of households have not been matched by market-based measures of long-term inflation expectations. The decline in 10-year Treasury yields in the first quarter has been dominated by a decline in real yields, with 10-year average inflation expectations remaining little changed. However, the market's short-term expectations for inflation, like those of households, have spiked.

Golden Twenty-First Century

President Nixon suspended the dollar's fixed peg to gold at \$35 per ounce in 1971, thus ending the Bretton Woods system governing international trade and payments. Since then, the value of the dollar has fallen from 1/35th of an ounce of gold to 1/3,000th of an ounce. The price of gold has risen especially fast since the Great Financial Crisis, reaching \$1,000 for the first time in 2008, \$2,000 in 2020, and \$3,000 in March. Gold has handily outperformed U.S. equities and other assets in the 21st century, reflecting concerns, at various times, over financial stability, price stability, and geopolitical stability (Exhibit 4). It is up 18% so far this year.

Exhibit 4. Gold Outshines Equities and Other Assets

Source: Bloomberg. Index. January 1, 2000 = 100.



Performance of Major Market Indices through 03-31-2025

Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.

	1-Month	QTD	YTD	1-Year	3-Year	5-Year
S&P500	-5.6%	-4.3%	-4.3%	-4.3%	8.3%	9.1%
Russell 2000	-6.8%	-9.5%	-9.5%	-9.5%	-4.0%	0.5%
MSCI World Ex-US (USD)	-0.6%	6.2%	6.2%	6.2%	5.3%	5.7%
MSCI Emerging Mkts (USD)	0.6%	2.9%	2.9%	2.9%	8.1%	1.4%
Citigroup US Treasuries	0.2%	2.9%	2.9%	2.9%	4.6%	-0.1%
Citigroup Credit	-0.3%	2.4%	2.4%	2.4%	5.1%	1.2%
Merrill High Yield	-1.1%	0.9%	0.9%	0.9%	7.6%	4.8%
JPM EMBI Global (USD)	-0.5%	2.3%	2.3%	2.3%	6.7%	3.2%
Citigroup WGBI Ex-US (LC)	-1.2%	-1.0%	-1.0%	-1.0%	0.5%	-2.0%
Barclays US Aggregate	0.0%	2.8%	2.8%	2.8%	4.9%	0.5%
GSCI Total Return	2.9%	4.9%	4.9%	4.9%	3.8%	1.3%
HFRX Eq. Wtd. Strategies	-0.4%	1.0%	1.0%	1.0%	3.5%	2.2%