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Oh Baby, Baby, It's A Wild World

Navigating global market uncertainty amid heightened US political turbulence and shifting trade policies.

Key Points

- **Heightened US political uncertainty is weighing on the outlook for global growth and inflation.** Still, we're not in the US recession camp and think fundamentals continue to support a slight overweight view on global equities relative to bonds.
- **Equity broadening is having its moment across regions and styles,** making a case for balance between developed markets (DM) and emerging markets (EM), as well as value and growth. While adding to non-US DM equities is tempting, we think recent repricing warrants waiting for a better entry point. We remain neutral on EM equities, given attractive valuations and some improvements in China.
- **We're neutral on duration[1] and have a slightly overweight view on credit.** The Federal Reserve (Fed) is caught between concerns about slower growth and higher inflation, which may keep yields rangebound. We've raised our view on high yield given spread[2] widening and a supportive supply/demand picture.
- **We think stagflation worries (stagnant growth, high unemployment, and high inflation), geopolitical risks, and central-bank buying could add up to a structural case for gold** to continue to do well. Given record-breaking price levels, however, we've reduced our overweight view.
- **Downside risks** include an expansion in the tariff war or geopolitical tensions, stickier/reaccelerating inflation, and disappointing developments in Europe or China. **Upside risks** include a more measured approach to tariffs and progress on the US administration's plan to reduce taxes and regulations. Signs of a stable US economy and cooling inflation could also improve the outlook.

Insight from sub-adviser Wellington Management

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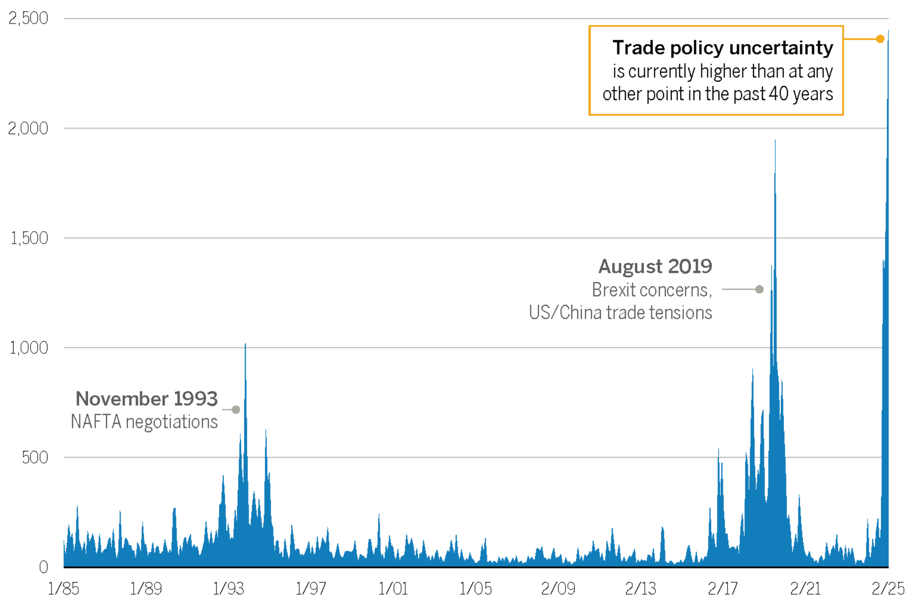
Along with death and taxes, it seems we can add "uncertainty" to the list of things that are, well, certain. Some policy uncertainty was expected going into 2025, but after just one quarter, several assumptions about the year have been upended:

1) US exceptionalism is no longer a given;
2) Tariffs appear to be more than just a negotiating tool for President Donald Trump's administration, and have hit at higher levels than expected, though this issue is far from settled (**FIGURE 1**);
3) Rather than moving toward a rate-cutting cycle with a soft landing, the Fed finds itself boxed into inaction by a mix of softer growth and higher inflation; and
4) An equity-market sell-off turned out not to be the guardrail some expected against extreme policy decisions.

A wild world indeed!

FIGURE 1
Welcome to a Wild World
US Trade Policy Uncertainty Index



Monthly data from 1/15/85–2/15/25. The **US Trade Policy Uncertainty Index**, developed by Federal Reserve economists, measures the frequency of joint occurrences of "trade policy" and "uncertainty" terms in major newspapers, with a reading of 100 indicating 1% of news articles discuss both. Data Sources: Wellington Management and Refinitiv.

Despite this backdrop, we have a slight pro-risk stance. Our base case is that we think the US could avoid recession, and we're comfortable with a moderately overweight view on global equities and credit, and a tilt toward adding risk at cheaper valuations. We moved our credit view from neutral to moderately overweight when high-yield spreads widened by about 80 basis points (bps).[3] Credit has been a stalwart in recent years, offering attractive yields, reliable returns, and strong supply/demand technicals.

As we expected coming into this year, broadening has become a strong theme in the markets, with dramatic rotations in styles and regions. With US mega-cap technology falling from its perch, growth has underperformed value by about 10 percentage points year-to-date in the US[4] and by a similar magnitude across regions.[5] Non-US equities, meanwhile, have outperformed thanks to fiscal policy, including Germany's plan to make a massive €1 trillion investment in military and infrastructure, which helped catapult European equities led by defense, financials, and industrials.[6] Chinese equities also benefited from government stimulus, as well as from a competitive technology sector.

We think the broadening theme could continue, and our neutral regional stance reflects our view that positioning should be balanced across regions. We also see earnings growth and revisions inflecting positively in Europe and Japan, which we think could help narrow the gap between US and non-US equity valuations. We expect US government bond yields to be rangebound, caught between the push and pull of slower growth and higher inflation—a theme affecting Europe and the UK as well.

Equities: Keeping an Eye Out for Entry Points After the Correction

We retain a slight overweight view on global equities. One of the key questions today is whether the recent sell-off signalled the end of the bull market or if it

Our Multi-Asset Views

Asset Class	View	Change
Global equities	Moderately OW	—
DM government bonds	Neutral	—
Credit Spreads	Moderately OW	↑
Commodities	Neutral	↓
Cash	Moderately UW	—
Within Asset Classes		
Global Equities		
US	Neutral	↓
Europe	Neutral	↑
Asian DMs	Neutral	—
EMs	Neutral	—
DM Government Bonds		
US government	Neutral	↑
Eurozone government	Neutral	↓
UK government	Neutral	—
Japan government	Neutral	—
Credit Spreads		
US high yield	Neutral	—
Europe high yield	Neutral	—
Global investment grade credit	Neutral	—
EM debt	Neutral	—
Bank loans	Neutral	—
Securitized assets	Neutral	↓

OW = overweight, UW = underweight

Views have a 6-12 month horizon and are those of the authors and Wellington's Investment Strategy Team. Views are as of 3/31/25, are based on available information, and are subject to change without notice. Individual portfolio management teams may hold different views and may make different investment decisions for different clients. This is not to be construed as investment advice or a recommendation to buy or sell any specific security.

was simply a correction. We don't see evidence of an earnings or economic recession, which are usually associated with a bear market. Instead, we think this was more likely a correction driven by a repricing of growth expectations given tariff concerns and policy disruption, and that we may see further adjustments in headline earnings-per-share (EPS)[7] growth as expectations evolve.

Thus, we're watching for better entry points amid near-term volatility, while also remaining mindful of the fact that missing the early stage of a rebound can be costly. Over the next 12 months, we expect mid to high single-digit earnings growth and flat valuations in global equities, based on our probability-weighted approach and assuming a reasonable likelihood of higher tariffs with negative growth/inflation trade-offs.

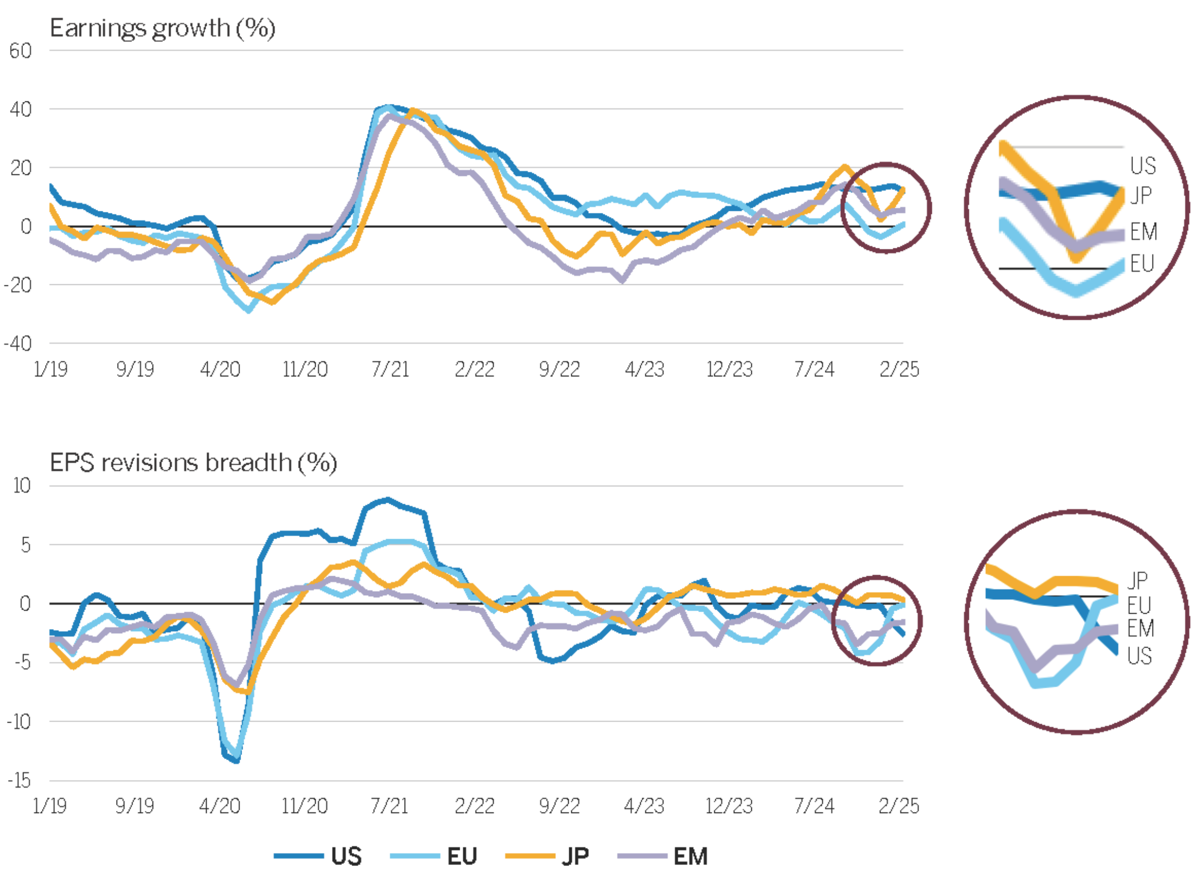
> We don't see evidence of an earnings or economic recession.

Another key question occupying allocators recently was whether equity-market leadership would finally broaden. At the start of the year, we expected some broadening, both regionally and within the US, which led us to neutralize our regional overweight/underweight views (we previously had an overweight view on the US vs. Europe). The unusually asynchronous moves we've seen between regions through the first few months of the year have exceeded our expectations.

The upending of the consensus on US outperformance is reflected in investor surveys and equity flows, where we've seen some historically large shifts out of the US and largely into Europe, where earnings revisions have risen sharply (**FIGURE 2**). Both cyclical indicators and signs of a sea-change in fiscal dynamics give us some indication of the potential bull case for Europe. However, the abrupt gains in the market have pushed valuations to more expensive levels, and we'll need to see EPS improve further to gain confidence that we've entered a sustained period of outperformance. In addition, we think neither US tariffs nor implementation risk (e.g., borrowing for defense spending) have been adequately reflected in valuations.

FIGURE 2

Earnings Outside the US Have Been Turning Up



Monthly data from 1/31/19–2/28/25. EPS revisions breadth defined as the number of companies with upward revisions minus the number of companies with downward revisions divided by the total number of companies with revisions. Data Sources: Wellington Management and Refinitiv.

In the US, it seems reasonable to expect that perceptions of heightened policy risk could pressure valuations lower from record levels (i.e., economic-policy uncertainty may continue to weigh on the US equity risk premium).[8] Taking this and weaker earnings breadth into account, we're not tempted to move to an overweight view on US equities despite the sell-off.

Japan has underperformed despite solid earnings growth, modest valuations, and continued bottom-up progress on shareholder return and governance. Policy has been a headwind, with the Bank of Japan still in tightening mode. We maintain our neutral view but are still constructive on the structural story.

In EMs, recent gains have been driven mainly by a repricing of China, where housing indicators appear to have bottomed out and private-sector sentiment has improved, particularly in the technology sector. We maintain a neutral stance on EMs broadly.

Within sectors, we have an overweight view on utilities, financials, industrials, and technology, against an underweight view on telecoms, energy, and staples. Utilities and industrials are our highest-conviction views, driven by fundamental tailwinds, including infrastructure and defense spending.

> In the US, perceptions of heightened policy risk could pressure valuations lower from record levels.

Government Bonds: Focusing on Fiscal Divergence

The market focus shifted from inflation to growth in the first quarter, and US yields fell around 50 bps. We have a neutral view on duration as we expect slower growth and sticky inflation to keep the Fed on hold and the US 10-year yield rangebound in the coming months. Globally, we see divergence in fiscal policy, with the rest of the world loosening spending relative to the US. The most dramatic example of this was the 50 bps spike in German yields following the new chancellor's announcement that defense spending would be removed from the country's debt brake.[9] With these big moves behind us, however, we're loath to pile on to a regional duration view and prefer a neutral view across regions.

We think markets should remain vigilant in treating the US 10-year Treasury as a barometer of growth and inflation expectations, and considering its impact on other asset classes. With fiscal spending a key issue for all countries, stronger growth could impact the neutral policy rate and/or change perceptions of the term premium.[10] If the market were to switch focus in the US from growth back to inflation, we think higher rates could expose US equities to downside relative to other regions, given still-expensive valuations.

Credit: Still Comfortable With High Yield

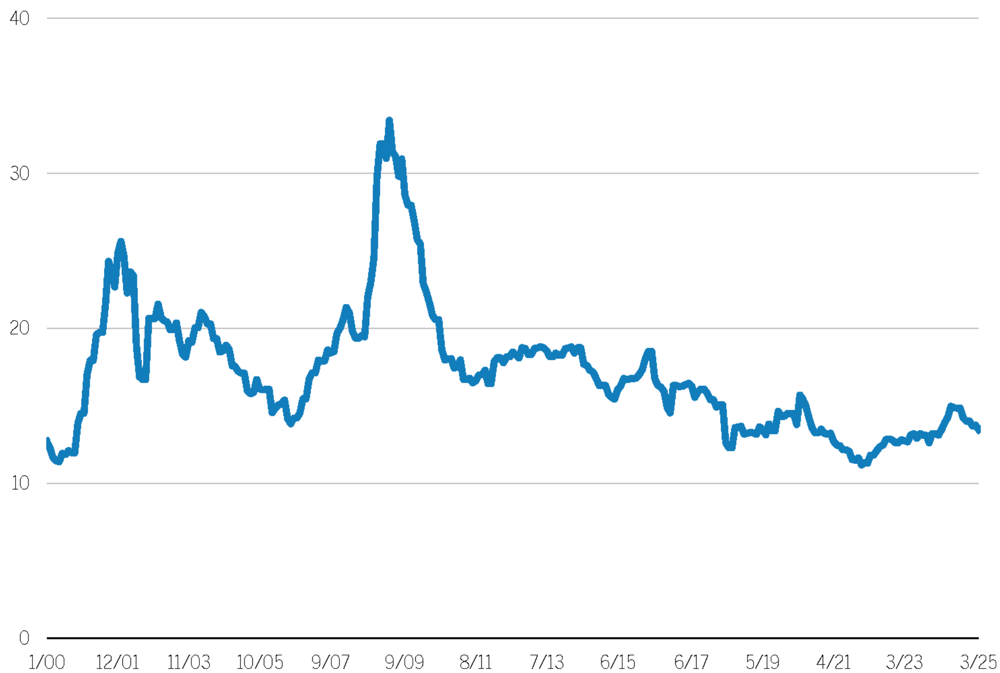
Credit has remained well-behaved even in the face of the US equity-market correction, and we've seen a pattern in recent years of mean reversion[11] when spreads widen. For this reason, we raised our view on US high yield when spreads widened from +254 bps to +335 bps. We continue to have a favorable view of high yield due to its improving quality (**FIGURE 3**) and attractive all-in yield, and we estimate that spreads could still widen by as much as 100 bps before breaking even with Treasury returns, though we don't expect spreads to reach that level. Supply/demand technicals also continue to be supportive, with private credit replacing some financing, and plenty of capital looking for a home in this space. Given our base-case economic scenario of no recession, we may look to add exposure at wider spreads.

We lowered our view on securitized assets to neutral as valuations look less attractive relative to more liquid parts of the credit market. We favor higher-quality assets at the front end of the yield curve[12] for income, and see value in select areas of housing in the non-agency market, where the tight supply relative to demand remains a solid support for home prices.

FIGURE 3

Quality Has Been Improving in High Yield

CCC and Lower-Rated Debt Outstanding as a % of Total Index



Data from 1/1/00–3/1/25. Indices used: **ICE BofA US High Yield Index**, which tracks the performance of US dollar-denominated below-investment-grade-rated corporate debt publicly issued in the US domestic market. **ICE BofA CCC & Lower US High Yield Index**, which tracks the performance of US dollar-denominated, below-investment-grade corporate debt that is rated CCC or lower and is a subset of the broader ICE BofA US High Yield Index. Data Sources: Wellington Management and Refinitiv.

Commodities: Time To Push Pause on Gold?

We've moved to a neutral view on commodities from overweight last quarter. Following the extreme gains in gold, we've shifted to a smaller overweight view. We think the geopolitical environment could remain favorable for gold, with both EM central banks and retail investors (via gold ETFs) participating, and the impact of tariff risk on physical flows of gold providing an additional kicker. But while we acknowledge the strong uptrend (albeit with some volatility), we think it's worth waiting for a more favorable entry point for a long position.

On oil, we remain neutral. On the supply side, OPEC production is flat as the group gradually unwinds several years of production cuts, while US supply growth isn't expected to grow meaningfully. The demand side has been held back by global growth concerns.

Risks to Our Views

Downside Risks Include:

- An escalation in policy uncertainty and disruption, including around tariffs and fiscal policy, and/or in geopolitical instability
- Signs that core inflation remains sticky or is starting to reaccelerate, leading central banks to push back against the current implied rate path
- A slip in global-growth momentum if the fiscal shift in Europe disappoints, or the modest bottoming of growth momentum in China falters—against a backdrop of higher tariffs and weak US growth

Upside Risks Include:

- A scenario in which tariffs are more limited than currently envisaged, and the Trump administration makes meaningful progress on its tax and deregulation plans
- Signs that US growth is stable and the labor market isn't weakening significantly, together with more positive signs on global growth (e.g., in Europe and China)
- A cooling of inflation, particularly in services, which could give the Fed room to cut rates more than expected in order to address concerns about the labor market and growth

Investment Implications

Here are four things investors may want to consider:

- **Maintaining a slight pro-risk stance** — Despite high policy uncertainty, our economic base case isn't a US recession. As such, we think allocators may still want to consider owning some risk in both global equities and credit. In global equities, we favor utilities and industrials, given fundamental tailwinds, including infrastructure and defense spending, along with financials and technology. We're more negative on energy, consumer staples, and telecoms.
- **Positioning for more potential broadening** — With fiscal spending ramping up in response to Trump's US-centric agenda, we expect the broadening theme in earnings growth outside the US to continue, especially in DMs. We think allocators may want to at least consider neutral exposure to DMs ex US.
- **Expect rangebound yields** — The duration narrative could flip flop between growth and inflation, causing yields to fall and rise within a range. We expect this to keep the Fed on hold and the US 10-year yield rangebound. Allocators may be able to add alpha[13] by pursuing active strategies that exploit opportunities created when yields reach extremes.
- **Consider opportunities to add spread exposure** — Given a "no recession" base case, we looked at wider high-yield spreads during the equity-market correction as an opportunity to add risk. Other financing options for high-yield issuers in loans and private credit have structurally improved the supply, liquidity, and quality in the high-yield market.

Talk to your financial professional about how to position your portfolio amid a changing economic landscape.

[1] Duration is a measure of the sensitivity of an investment's price to nominal interest-rate movement.

[2] Spreads are the difference in yields between two fixed-income securities with the same maturity but originating from different investment sectors.

[3] A basis point is a unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security.

[4] Growth is represented by the MSCI USA Growth Index, which measures the performance of large and mid-cap US stocks expected to have higher earnings growth than the market average. Value is represented by the MSCI USA Value Index, which measures the performance of US large and mid-cap stocks with lower valuations relative to their peers. Source: Bloomberg, as of 4/25.

[5] Compares the performance of the MSCI World Growth Index against the MSCI World Value Index. The MSCI World Growth Index captures large and mid-cap securities exhibiting overall growth style characteristics across 23 developed-market (DM) countries. The MSCI World Value Index captures large and mid-cap securities exhibiting overall value style characteristics across 23 DM countries. Source: Bloomberg, as of 4/25.

[6] European equities are represented by MSCI Europe Sector Indices, which is a collection of indices designed to track the performance of specific sectors within the European market and categorizes companies based on their principal business activities. Source: Bloomberg, as of 4/25.

[7] Earnings per share measures how much profit a company makes per share of common stock.

[8] Risk premium is the investment return an asset is expected to yield in excess of the risk-free rate of return.

[9] In Germany, debt brake is a fiscal rule that limits how much debt the government can take on and dictates the maximum size of the federal government's structural budget deficit.

[10] The term premium is the amount by which the yield on a long-term bond is greater than the yield on shorter-term bonds. This premium reflects the amount investors expect to be compensated for lending for longer periods.

[11] Mean reversion, or reversion to the mean, is a theory used in finance that suggests that asset price volatility and historical returns eventually will revert to the long-run mean or average level of the entire dataset.

[12] The yield curve is a line that plots interest rates of bonds having equal credit quality but differing maturity dates; its slope is used to forecast the state of the economy and interest-rate changes.

[13] Alpha measures an investment's excess return relative to a benchmark index.

Important Risks: Investing involves risk, including the possible loss of principal. • Foreign investments may be more volatile and less liquid than U.S. investments and are subject to the risk of currency fluctuations and adverse political, economic and regulatory developments. These risks may be greater, and include additional risks, for investments in emerging markets or if focused in a particular geographic region or country. • Small- and mid-cap securities can have greater risks and volatility than large-cap securities. • Different investment styles may go in and out of favor, which may cause underperformance versus the broader stock market. • Fixed income security risks include credit, liquidity, call, duration, and interest-rate risk. As interest rates rise, bond prices generally fall. • Investments in high-yield ("junk") bonds involve greater risk of price volatility, illiquidity, and default than higher-rated debt securities. • Municipal securities may be adversely impacted by state/local, political, economic, or market conditions. Although municipal securities are generally exempt from federal income taxes, investors may be subject to the federal Alternative Minimum Tax as well as state and local income taxes. Capital gains, if any, are taxable. • Loans can be difficult to value and less liquid than other types of debt instruments; they are also subject to nonpayment, collateral, bankruptcy, default, extension, prepayment and insolvency risks. • The value of inflation-protected securities (IPS) generally fluctuates with changes in real interest rates, and the market for IPS may be less developed or liquid, and more volatile, than other securities markets. • Obligations of U.S. Government agencies are supported by varying degrees of credit but are generally not backed by the full faith and credit of the U.S. Government. • Investments in the commodities market may increase liquidity risk, volatility and risk of loss if adverse developments occur. • Diversification does not ensure a profit or protect against a loss in a declining market.