SIGMA
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Q1 2025 MARKET REVIEW AND OUTLOOK

MARKET REVIEW & OUTLOOK

Global equity markets entered 2025 with strong momentum after a solid 2024. Yet as we highlighted in our Q4 2024 Market Review & Outlook, "the potential for a correction should be part of every investor's expectation for 2025." That expectation has now materialised. After more than a year of steady gains, equities faced their first significant pullback, with the S&P 500 and Nasdaq both falling over 10% from recent peaks.

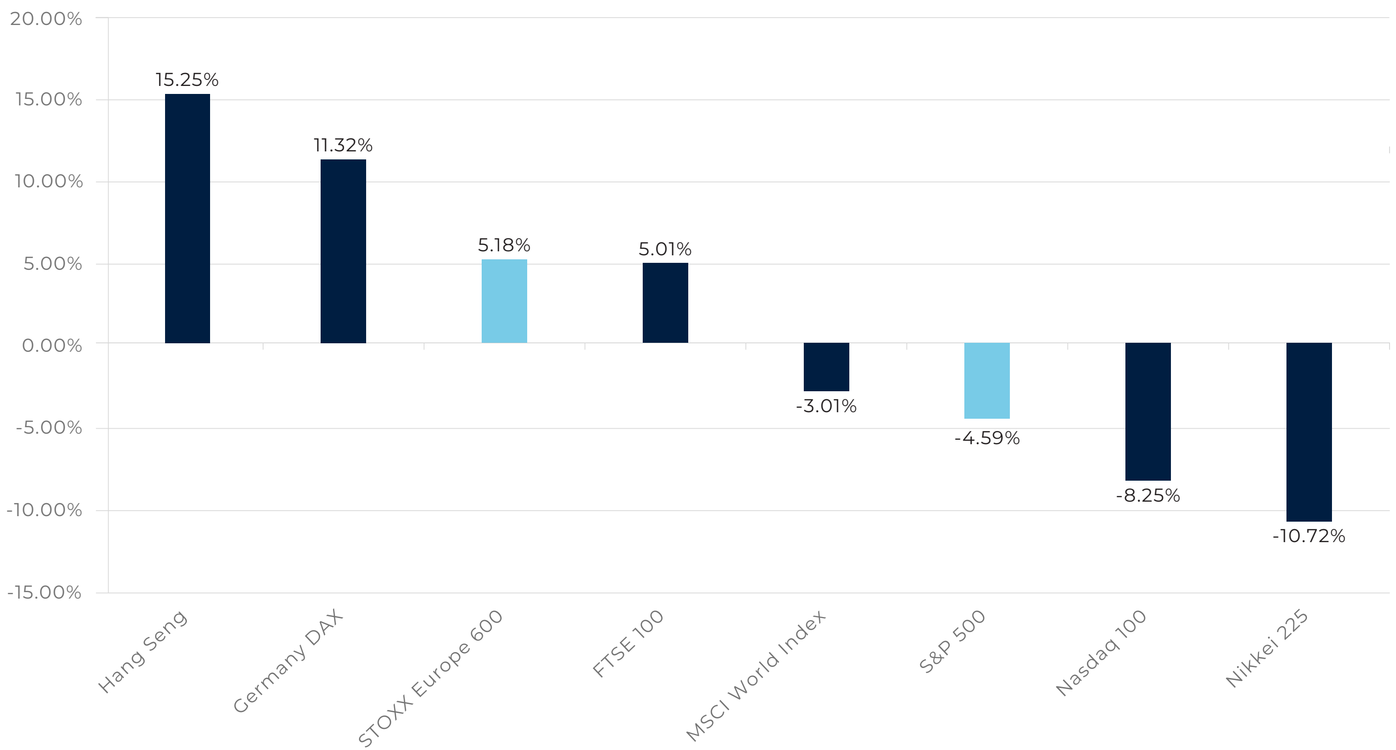
Such corrections, while unsettling, are normal and necessary parts of a healthy market cycle. They clear out speculative excess, reset expectations, and set the stage for continued growth. Furthermore, history has repeatedly demonstrated that well-known risks, like current concerns over tariffs, monetary policy uncertainty, and geopolitical tensions rarely cause bear markets.

> *'The key for investors is recognising that short-term volatility is a feature of long-term investing, not a signal to change course.'*

One of the most notable developments this quarter has been the outperformance of the European equity market. European equities have surged relative to the US, outperforming the S&P 500 by almost 10 % year-to-date, one of the sharpest rotations in market leadership we've seen in the past two decades. Towards the backend of last year, investor sentiment towards Europe was deeply pessimistic, weighed down by fears of stagflation, political uncertainty, and fiscal constraints. However, markets move on the gap between expectations and reality, and with expectations for Europe so low, a slight upside surprise was enough to trigger a meaningful rally.

CHART 1

MAJOR INDICES FIRST QUARTER PERFORMANCE

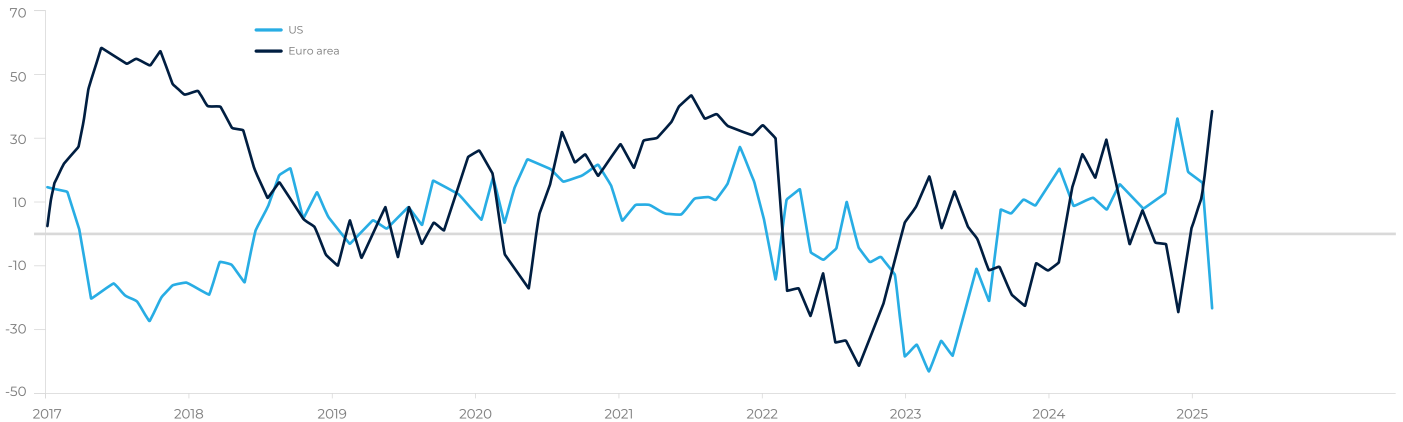


Source: FactSet. Data as of March 31, 2025

Sentiment towards Europe has been further buoyed this year amid expectations of a Russia-Ukraine ceasefire, German election stability, and ambitious plans for defense and infrastructure spending. This sudden shift in leadership can be seen in positioning, with the latest Bank of America Global Fund Manager Survey (Chart 2) showing a net 23% of investors now underweight U.S. equities, the biggest contraction on record and the lowest reading since mid-2023, while a net 39% report being overweight Eurozone equities versus their benchmark, the highest level since mid-2021.

CHART 2
FUND MANAGER POSITIONING HAS SHIFTED SIGNIFICANTLY

Net % of global FMS participants saying they are overweight



Source: BofA Global Fund Manager Survey. Data as of March 18, 2025

However, we believe a lot of the European catch-up trade has already been priced in and remain cautious about extrapolating Europe's recent strength into a longer-term trend. Firstly, periods of extreme positioning rarely last, as illustrated by recent Goldman Sachs analysis. Historically, US underperformance versus Europe has usually been temporary and followed by sharp rebounds as demonstrated in Chart 3. On average, during past episodes of similar underperformance since 2009, US equities recovered strongly, outperforming European markets by approximately 11% in the six months that followed.

CHART 3
US RELATIVE UNDERPERFORMANCE VS EUROPE HAS BEEN SHORT-LIVED SINCE THE GLOBAL FINANCIAL CRISIS

S&P 500 vs STOXX 600 - Peak-to-Trough

Start	End	Relative Performance	Calendar Days	+6m
7-May-10	9-Sep-10	-12%	125	13%
13-Sep-11	3-Oct-11	-8%	14	10%
18-Jun-12	28-Dec-12	-10%	193	12%
15-Dec-14	13-Apr-15	-23%	119	9%
6-Jul-16	17-May-17	-10%	315	11%
9-Mar-18	2-May-18	-8%	54	8%
6-Dec-18	24-Dec-18	-10%	18	11%
4-Mar-22	10-Mar-23	-18%	371	16%
24-Dec-24	13-Mar-25	**-16%**	**79+**	
Average		-13%	151	+11%

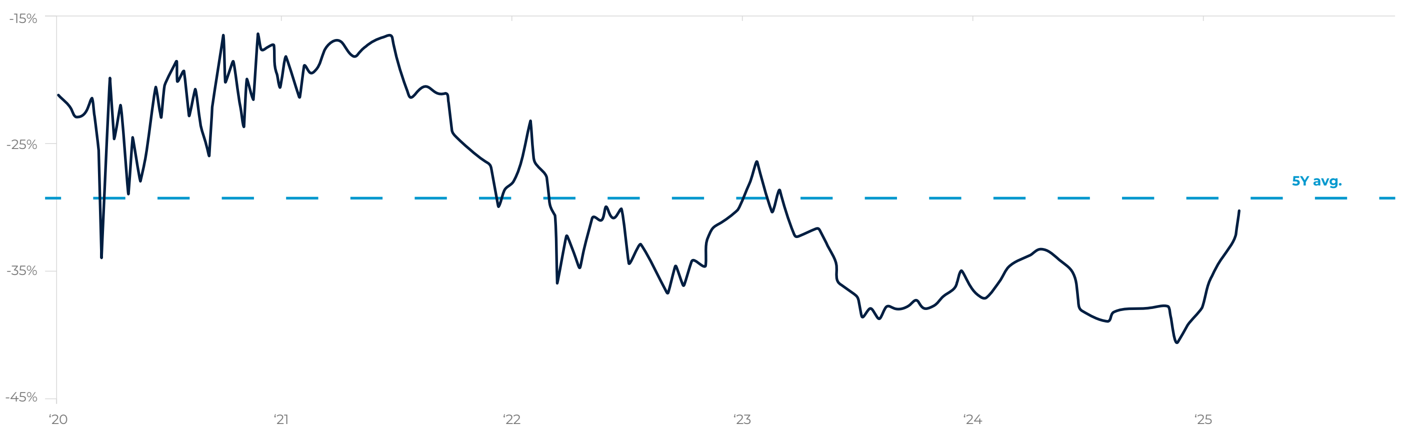
Source: Bloomberg, Goldman Sachs - Investment Strategy Group. Data as of March 20, 2025

Secondly, the recent rally in European equities has been sentiment driven and largely hinges on expected fiscal stimulus. This anticipated stimulus will require multiple layers of approval before implementation. The political reality of European fiscal policy, where consensus-building is slow and spending plans are subject to intense scrutiny, means the actual economic impact is likely further out, with most of the benefits not materializing until 2026 or 2027, if at all. A lot can still happen between now and then.

Most importantly, the fundamental driver of equity market returns over the long run is earnings growth. Here, the US continues to be far superior with double-digit earnings growth forecasted for 2025, versus just 5-6% in Europe. Additionally, the recent market correction has brought relative US valuations back in line with historic norms, as shown in Chart 4, making the outlook for US equities more attractive in our view.

CHART 4

EUROPEAN EQUITIES' DISCOUNT NARROWS TO US, BACK-IN-LINE WITH 5 YEAR AVERAGE



Source: Bloomberg, JPMorgan. Data as of February 26, 2025

Nonetheless, investors are clearly beginning to question US dominance. While initially, they welcomed the possibility of deregulation and pro-business policies, uncertainty has grown this past quarter over how far the Trump administration is willing to take its aggressive stance on tariffs. However, history suggests his approach to tariffs is more tactical than structural.

During his previous term, tariffs were frequently introduced as leverage in broader negotiations, and often scaled back or revised once political objectives were met. There is little reason to believe this time will be entirely different. What is ironic, in our opinion, is that many of today's concerns are focused solely on the US economy, while investors appear to be overlooking the disproportionate impact these measures could have on America's trading partners, notably Europe and China, where economies are far more dependent on exports. This asymmetry is precisely what gives US tariffs their negotiating power.

Furthermore, tariffs are often misunderstood. The idea that they inherently cause inflation is flawed. While they can raise prices on specific goods, inflation is broadly rising prices economywide and results from too much money chasing too few goods and services. Tariffs may shift demand and create winners and losers across sectors, but without an increase in money supply, they don't translate into sustained inflation. Businesses are also more adaptable than many assume, often reworking supply chains, renegotiating contracts, or adjusting pricing to mitigate impact. This flexibility helps explain why past tariff cycles have had limited long-term effects on inflation or corporate profitability.

As such, markets tend to overreact to tariff announcements, only to recover once the real economic impact proves more limited than feared. That said, the recent escalation in trade rhetoric has contributed to a surge in US economic policy uncertainty, which now stands in its 99th percentile as seen in Chart 5. While unsettling, history offers perspective; in 8 of the last 10 spikes in policy uncertainty, the S&P 500 delivered strong double-digit returns over the following year (Chart 6), as concerns receded, and sentiment recovered.

CHART 5
US ECONOMIC POLICY UNCERTAINTY INDEX HAS SPIKED

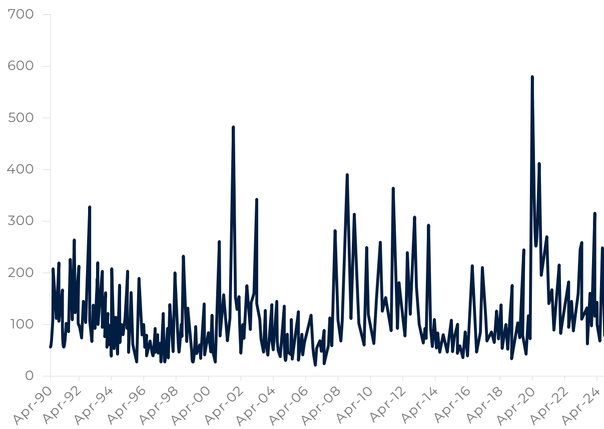
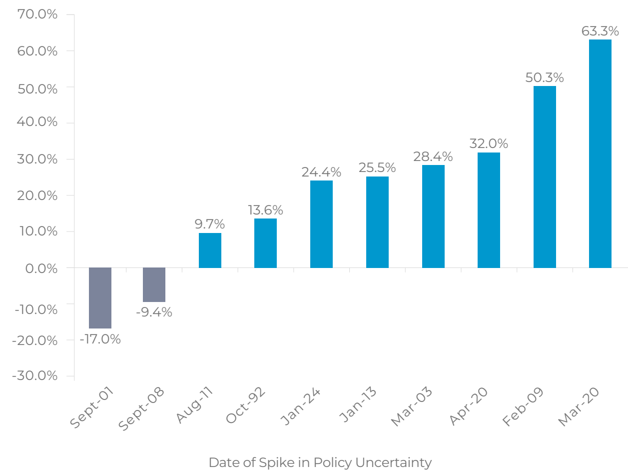


CHART 6
RETURNS A YEAR AFTER SPIKE IN POLICY UNCERTAINTY INDEX HAVE TYPICALLY BEEN STRONG

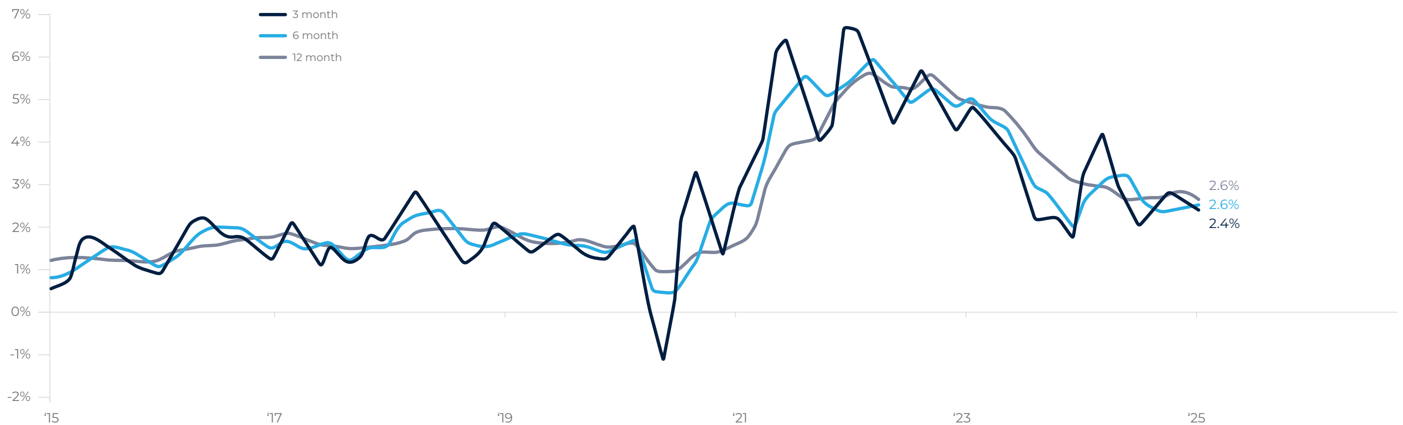


Source: Bloomberg, Goldman Sachs - Investment Strategy Group. Data as of March 20, 2025

To give some additional context, Goldman Sachs estimates that even in a worst-case scenario US GDP growth in 2025 would take a 1.3% hit, enough to cause a notable slowdown, but falls short of a complete collapse. It would take a far more severe and unanticipated shock to derail the global economy. As it stands, the IMF forecasts global GDP growth of 3.3% in 2025, or nearly $3.8 trillion in added output. To unwind that momentum and cause a bear market, we would need to see a sharp deterioration in fundamentals significant enough to cause a global economic and/or earnings recession. Tariffs fall far short of the scale required to trigger a bear market and a deeper look at macroeconomic data suggests recession risks remain low.

While we have seen US economic data somewhat disappoint in the first quarter, it has largely been due to a deterioration in sentiment indicators, with consumer and business surveys reflecting pessimism amid an equity market selloff, tariffs and stagflation fears. The hard data on the other hand continues to tell a more constructive story; consumer spending, retail sales, and labour market indicators remain resilient and an upturn in manufacturing seems to be materialising. Furthermore, inflation remains sticky but is not reaccelerating. Core PCE (Personal Consumption Expenditure), the Fed's preferred inflation measure, has held in a 2.6%–2.9% range for the past 10 months as shown in Chart 7, and shorter-term trends suggest continued disinflation. In our view, the Fed has the flexibility to cut rates if growth unexpectedly weakens but is in no rush to do so unless necessary.

CHART 7
US CORE PCE IS NOT REACCELERATING



Source: Haver Analytics, JPMorgan. Data as of January 31, 2025

Outside the US, the picture is more mixed. Europe's growth outlook remains muted, especially relative to the US, despite improved sentiment and hopes for hefty defense and infrastructure spend. Nonetheless, green shoots are forming, and economic data is stabilising, albeit at low levels. In China, policy support and a rally in AI-linked equities have helped boost market sentiment, but the broader macro backdrop remains fragile, with consumption and the housing market still under pressure. Japan, by contrast, stands out positively, earnings are beating expectations, inflation is running at healthier levels, and wage growth remains robust.

Central banks were largely in pause mode this quarter, with the Fed, BoE and BoJ all holding rates steady as they assess the evolving macroeconomic landscape. Among the major developed markets, The ECB and The SNB were the only movers, delivering 25bps rate cuts in March amid soft growth and cooling inflation. Against this uncertain backdrop, bond markets saw renewed strength. US 10-year Treasury yields fell from 4.8% in mid-January to as low as 4.18% in early March. This move supported fixed income returns, with the Bloomberg Global Aggregate Bond Index up 2.5% year-to-date and helped cushion portfolios during a volatile quarter for equities, reaffirming the role of fixed income as a volatility dampener in balanced portfolios.

As we look ahead, uncertainty around trade, policy, and geopolitics is likely to remain elevated. But markets have a long history of climbing walls of worry. With fundamentals still intact and earnings continuing to drive returns, we believe staying invested, staying balanced, and staying focused on the long term remains the most effective way to navigate the noise.

We look forward to updating you again next quarter and thank you for taking the time to read our Market Review & Outlook.

Sigma Investment Committee

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