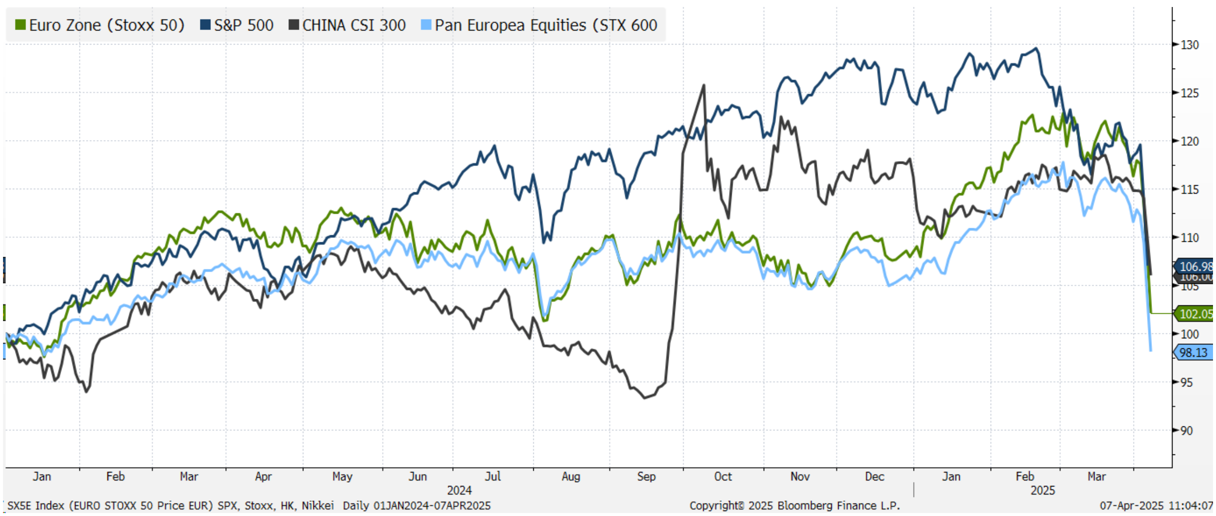
The elephant in the room

After a remarkable increase in noise and confusion after the election of Trump as the president of the United States, a new question is now emerging: can Trump be controlled? No one, except for Trump, said it would be easy to arrange a ceasefire in Gaza and in Ukraine. There is no such ceasefire yet, so it was not easy. Elon Musk's posts on X and the "Signal-gate" made it clear that the Trump administration is reckless and unable to communicate safely on social media without harming themselves. The introduction of trade tariffs, their calculation and communication made it clear that no one in his administration has the necessary will and influence on Trump when he wants headlines and attention on his main topics. As Trump said about trade tariffs on board Airforce One over the weekend, he had to do it because he had promised to do it. The result of this "necessary" action is a bear market in equities, directly from a president expected to be market friendly. All that said, we think that Trump can be moderated and that he possibly can be somewhat controlled, but only gradually. Important voices including Cruz, Ackman and Druckenmiller have started to help, so has JP Morgan's Jamie Diamon. That said, more noise and troubles are likely.

Exhibit 1 shows the market pricing as of this writing, Monday the 7th of April at lunch time (as this is based on live indices, the futures pricing of a decline of S&P 500 is not fully captured). The correction currently priced in the market is in line with the decline in case of an average recession. As it is far from certain that we will see such a recession in the US, we are not seeing a good case for reducing our equity allocation in our Dynamic Allocation Portfolio where we sold 30% and 40% respectively, reducing the position from 100% to 60% and from 70% to and 40%. This can obviously change as the global trade situation evolves and as our algorithms and analysis incorporate new data.

Exhibit 1: The Trump-driven bear market global sell-off in equities



Some commentators and investors, mainly in Europe, have argued that the European economies will be stronger and that the potential in European and Asian equities is better this year. This was certainly the case in January when these markets outperformed the US market. As seen in Exhibit 1 and as illustrated by the 13% decline in the Hang Seng and the 6-8% declines in European, Japanese and Chinese equities at the time of writing, such diversification did not work when really needed. We will therefore not attempt to protect our equity positions by allocating into other regions. Should the trade war accelerate, we maintain that Europe and Asia are more vulnerable than the US market and economy where we, for now, hold our main positions.

The situation is different in more defensive portfolios where we hold variable credit exposure. As seen in Exhibit 2, high yield spreads have not moved out in line with equity declines and they are far from pricing in a recession. We therefore see a good case for further reducing our holdings of high yield bonds and allocating to European and US government bonds as well as to global development bank bonds where relevant.

Exhibit 2: Euro and USD High Yield bond spreads are still not pricing in a recession

With uncertainty about central bank credibility and pressure, we prefer shorter duration bonds. There is however a structural issue in Europe. Italian bonds make up a very large part of the short duration market, so if one buys the shortest ETF, one gets a large weight of these bonds. In today's market and in previous cyclical sell offs, we see that the Italian bonds don't follow French and German bonds when they rally. So, while Ferrari's equity (listed in Holland) corrected 25% and, as such, went down in line with equity markets and Rheinmetall, Italian bonds don't provide the same protection as Germany and France, and we therefore prefer a 3-5year ETF with more of the latter.

Even if the US president thinks he had promised his voters to implement trade tariffs, a fair criticism launched by Ackman and Druckenmiller is that he did not have to do it this way. As Ackman points out, Trump did not have to do it so disruptively and in such a rushed way. As Druckenmiller made clear over the weekend, the amount and different levels of tariffs is not what he supports. One may also say that Trump is not a precise man who always keeps his word to the last comma, so why overdo it on trade? He is, however, a great populist, who wants to make his MAGA base happy and cheering for him. This brings us back to the issue with "the elephant in the room". Do the Republicans still support Trump and all of his policies? Clearly Ackman and Druckenmiller don't, and Senator Cruz from Texas has made it clear that the Republicans, in his view, will be crushed in the midterms, if they create a recession. Also, Jamie Dimona from JP Morgan is advocating a moderation and resolution to the trade war and warning against believing too much in American exceptionalism. Our hope and expectations are that Republicans will address the issue in the room, namely, how to moderate and control Trump. If the Republicans don't manage to convince Trump to compromise, and on the way, let him celebrate the outcome of the trade chaos as a victory, we will possibly have to move to defensive positioning. For now, we think Trump underestimated the chaos and will indeed move forward and do what will serve himself and his voters best, namely make a set of deals.

Best regards,

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