EDMOND DE ROTHSCHILD

MARKETING COMMUNICATION

LETTER FROM THE CIO AM

MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES
MAY 2025

BENJAMIN MELMAN
Global Chief Investment Officer, Asset Management

Has the Elephant Smashed the China?

So far this year, market performances have been essentially driven by political factors. The S&P500 index is now returning to its pre-Liberation Day levels, despite a major shock to the confidence of economic agents. The market rebound seems fuelled by a notion conveyed by the Trump administration that from July 4th, the government would turn the page on protectionism and switch to its tax cut and deregulation programmes.

THE SEQUENCING ENVISIONED FOR TRUMP'S PROGRAMME IS PLAUSIBLE BUT FRAGILE

- First, it is generally estimated that redrafting a trade treaty takes at least 18 months. It seems unlikely that the government will complete trade talks with its 14 main partners in just 3 months, let alone with all the others. In addition, while according to the latest news, discussions with China have resumed, they remain in an impasse. With China opting for a show of force, finalising the main trade issues by July 4th seems a lofty goal.
- Second, the enforcement of a new 10% floor on tariffs, the shock triggered by uncertainty, and the loss of confidence fuelled by the inconsistency of the administration's announcements can also derail growth and lead to a possible recession. Some chain reactions may already be at work (pause on investments and recruitments…) and company executives will not back-pedal according to the administration's political agenda. Companies have to make choices on a sound footing and will not necessarily adapt their decision-making based on the tone of the latest statement. In such an interdependent world, one cannot change the rules of trade or those of international political alliances so brutally without causing impacts that will only become fully apparent when a new, more stable, form of equilibrium emerges. If confidence has been partly lost, then it may be too late already. All the more so, as nobody can tell whether the tariffs around July 4th will be substantially lower than those previously announced.

In this environment, the risk appears dissymmetrical to us: investors are gradually positioning their portfolios based on a new, more favourable sequence of events - which may not unfold according to the Trump administration's plans and may have impacts we have not fully measured. Therefore, we prefer to lower our exposure to U.S. equities – an adjustment which has led to a modest equity underweight.

In Europe, the potential equity market rebound will be driven by the European institutions' ability to set plans in motion, rather than by hopes of economic growth in the months to come. In Germany, the announcement of a massive infrastructure and defence spending plan instigated by Mr Merz before he even entered the Chancellery shows that Europe can break the mould and surprise positively. The next stage will concern Europe's ability to implement the recommendations listed in the Draghi report, either in part or in full. Other than defence - a sector where budgets have already risen sharply - and plans to streamline bureaucracy, energy security could be another initial priority. There is also talk of strengthening the European financial system (finalise the banking union, combine national capital markets to create a single market supervised by a single regulatory authority, develop a European savings plan…) but the issue is complex, and many believe it cannot be addressed this year. Broadly speaking, Europe needs a powerful political impetus to forge ahead and achieve its goals. Merz should be elected as Chancellor on May 6th; the next few weeks are likely to be eventful and should provide us with more visibility of this “new deal”.

Our view on bond markets is neutral overall. Investors are expecting the Fed’s key rates to converge at around 3.1% towards the end of 2026, which is 30 basis points lower than the median forecasts of Fed members, and the ECB’s rates to move towards 1.5%. The U.S. economy would have to slip into a recession, causing additional rate cut forecasts, for duration to continue to support bond returns. Credit spreads are a true reflection of the uncertain economic outlook, in our view. In Europe in particular, corporate bonds seem to be partly protected by interplaying correlations: rising fears over the economy are causing spreads to widen as well as rates to fall, so overall, the effect on prices remains limited. Unless the economic scenario is shattered or inflation rebounds, this modus operandi is likely to continue. To sum up, bond markets remain much more attractive for their ‘carry’ yield than for their potential capital gain.

	Our convictions[1]	Changes compared to the previous month
ASSET CLASSES		
Equities	-	↓[2]
Fixed Income	=	→
Dollar	-	→[3]
Cash	=	→
EQUITIES		
US	-	↓
Europe (ex-UK)	=	→
UK	=	→
Japan	=	→
China	=	↓[4]
Global Emerging	=	→
SOVEREIGN BONDS		
US	=	→
Euro Zone	=	→
Emerging Markets	=	→
CORPORATE BONDS		
US Investment Grade	+	→
Euro Investment Grade	+	→
US High Yield	=	→
Euro High Yield	=	→

1. Range of investment committee ratings on the asset class/geographical zone (from -/- to +/+). Source: Edmond de Rothschild Asset Management (France). Ratings at 30/04/2025. **2.** Change date: 03/02/2025. **3.** Change date: 04/03/2025. **4.** Change date: 11/04/2025.

TO SUM UP

- Investors are gradually positioning themselves for a new, more favorable sequence. Nevertheless, the introduction of the new 10% tariff floor, combined with the persistent uncertainty generated by the Trump administration, may cripple economic growth and even lead to a recession in the US.
- In Europe, the market rebound depends more on the mobilization of institutions than on growth, with initiatives such as those of Mr. Merz in Germany and the potential to implement the recommendations of the Draghi report.
- In this economic environment, we prefer to reduce our exposure to US equities, which leads us to a slight underweight in equities, while we remain neutral overall on bond markets.

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

47, rue du Faubourg Saint-Honoré, 75401 Paris Cedex 08

Société anonyme governed by an executive board and a supervisory board with capital of €11,033,769 - AMF registration No. GP 04000015 - 332.652.536 R.C.S Paris

www.edmond-de-rothschild.com