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US assets call for further caution

The US administration is pushing the idea that the protectionist phase will end around the July 4th celebrations and that it will then focus on a programme of tax cuts and deregulation, which investors seem to believe in. The draft budget being drawn up in Congress does indeed raise hopes of a net fiscal stimulus of around 1% of GDP.

Does the US administration really intend to turn the page?

Our first point is that the trade talks are far from over, as the tensions with China and Europe have recently proven (with the announcement of a potential tariff hike to 50% from June 1st, a date then pushed back to July 9th).

While the new tariff framework aimed at restoring balance to the trade balance has not yet been finalized, the US administration may be opening a new front concerning other items in the balance of payments with section 899. This bill would allow the US Treasury to introduce a surtax on capital flows from investments owned by non-residents (dividends or interest) in countries that apply "discriminatory" taxes on US goods and services, though the scope of these assets has not been clearly defined at this stage. This section, which will be discussed in Congress, has the potential to generate volatility across US assets or trigger measures of retorsion if it is effectively applied.

Will the page turn easily?

Investors are currently facing important questions. Will the current trade talks derail or escalate? In the US, will the looming 'stagflation trough' in H2 due to the tariffs be more problematic than initially believed (notably with the risk that inflation forecasts 'disconnect')? Could the US bond market rebel if it is made to fund a deepening public deficit, considering that the latter is already staggeringly high (7.2% in 2024)? And finally, doubts over whether international investors – who are already highly exposed to the dollar – will accept to raise their exposure further, when this involves funding a deep current account deficit (3.9% in 2024) also add further uncertainty to the many unanswered questions at this stage.

Flows are shifting away from the United States towards Europe and emerging countries

European equity markets outlook

Over the past few weeks, we have observed that capital flows into European and emerging equity markets, which had been largely overlooked in global portfolios, have resumed. We believe this trend is set to last.

While the outlook for growth in Europe remains modest and weakened by poor visibility on the economic environment and on US policy decisions, Europe's ability to address new challenges should not be underestimated. Eyes are now on Germany, where in just a few weeks, the new Chancellor has surprised observers with the magnitude of the structural recovery plan and with unconventional announcements regarding the military support provided to Ukraine.

Implementing the recommendations of the Draghi report, which are politically complex to enforce, requires a renewed European leadership to overcome the hurdles. Clearly, the changes occurring in Germany are aligned with this objective and should mitigate the current scepticism. If Europe chooses to forge ahead with the Draghi reforms, European equities will benefit from a rerating. Merely raising the question could prompt investors into lowering their European equity underweight and sustain capital inflows.

Tailwinds for emerging markets

Furthermore, several favourable factors are supporting emerging markets: the prospect of an end to the protectionist phase, with more acceptable tariffs than those announced on Liberation Day, a bearish consensus on the dollar, and signs that China – and notably its real estate sector - is emerging from its deflationary crisis.

The rate cuts introduced by the People's Bank of China, and notably the cut to the loan prime rate, bode well for the stabilisation of real estate investments. Finally - a key factor for emerging markets, we believe that China will continue to announce fiscal stimulus measures throughout the year to revive domestic growth and limit the country's reliance on external trade, as demonstrated by the recent statements issued by the government claiming that the measures designed to stabilise the job market will come into force by June.

Allocation: US assets call for further caution

In this environment, we have kept our asset allocation stable with a modest equity underweight (underweighting the US) and under-exposure to the US dollar.

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

Range of investment committee ratings on the asset class/geographical zone (from -/- to +/+). Source: Edmond de Rothschild Asset Management (France). Ratings at 31/05/2025.

TO SUM UP

- Many uncertainties remain concerning the United States, mainly due to the risk of slippage in ongoing tariff negotiations, with the threat of inflation expectations going off track.
- The return of capital flows into European and emerging markets, which had been largely overlooked in global portfolios, is set to last.
- We are maintaining a modest equity underweight (underweighting the US) and under-exposure to the US dollar.

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