Independent Adviser's Report for Teesside Pension Fund Committee

William Bourne **9th June 2025**

Market Commentary

1. In March I said I was slowly turning more negative about the medium-term prospects, primarily because of valuations. Nearer term I expected economic growth to slow and bond yields to rise.

2. A lot has happened since then. The Trump Administration has imposed tariffs on friend and foe alike using powers designed to be used in emergencies. That was expected, but the rapidly discredited methodology (e.g. the highest tariffs on countries like Lesotho) and the constant flip flops since the announcement were not. Moreover, the direction of travel is clearly towards protectionism.

3. China and the U.S. raised tariffs on each other well above 100% before agreeing a temporary reprieve, due to run out in August. However, Trump then reimposed 50% (previously 25%) tariffs on steel and aluminium. Other countries, including the U.K., are claiming a deal, but the details are unclear.

4. One estimate[1] is that if imposed in full tariffs will affect 71% of U.S. imports, lower U.S. GDP by 0.8% and raise an additional US$200bn of revenue annually over the next 10 years. The average effective rate would be 12.4%, the highest since the early 1940s. But this estimate does not take into account retaliatory actions other nations will surely take.

5. The battle then moved to the law courts. Two federal court judgements found that Trump had exceeded his authority by using emergency powers. If this is confirmed by higher courts, it would be a significant blow to Trump's plans. But even so, tariff levels would still be the highest since 1973.

6. Much damage has already been done to international trade. Corporates will be sensitive to the risks of long supply chains, and especially those involving China. It is likely that they will tend to 're-shore' i.e. site factories near their markets. This may benefit some communities, as Trump hopes, but there can be no doubt that overall it will be a negative for prosperity.

[1] U.S. Tax Foundation www.taxfoundation.org

7. The Trump administration also (by one vote after the death of a Democrat) passed its tax bill, which extends income tax reduction, and cuts spending on Medicaid, food stamps and clean energy tax credits. The net impact on the current U.S. 6 to 7% primary deficit (i.e. revenue minus spending) is likely to be limited, and U.S. federal debt levels will continue to rise to unprecedented levels.

8. The combination of tariff uncertainty, fiscal looseness, and low economic growth led to Moody's cutting the U.S.'s credit rating. The 30-year long term bond yield rose above 5% for the first time since before the 2008 Global Financial Crisis. Investors are increasingly wary about U.S. government debt, as the Government now spends 18% of total U.S. revenue on servicing debt, more than they are spending on defence.

9. The proposed tariffs also put pressure on other countries. China has hit back with restrictions on rare earth exports, which are critical to many high-tech products nowadays. They have also put into action export routes through third parties to try and reduce the impact of the U.S. tariffs. However, they are suffering from an overvalued currency, deflation, and their own debt overhang in the real estate sector. They will struggle to generate the higher economic growth they need.

10. Equity markets have remained extraordinarily resilient against all this bad news, perhaps clinging to the hope of more rate cuts. However, that would likely be associated with a recession, impacting earnings growth. I commented last time that valuations in the U.S. are 25% higher than the rest of the world, and that broadly remains the case.

11. Looking forward, the Federal Reserve has at least four plates to try and keep spinning: its two formal objectives of 2% inflation (currently 2.4%) and maximising employment; and two less formal but if anything even more important ones: to prevent a financial crisis, and to finance (or increasingly to refinance) the U.S. Government's debt. In my view it is inevitable that it will drop at least one plate, and the question investors need to ask is which.

Portfolio recommendations

12. The focus over the next twelve months or so will inevitably be on the details of how the Fund can meet with the requirements of the new Pensions bill. But we must be braced for lower and more volatile investment returns from the combination of low growth, stubbornly high inflation and much higher bond yields. The Fund is already relatively defensively positioned relative to history, and at this stage I do not recommend any changes to this stance.