Vontobel

Investors' Outlook

Tariff tangos

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For US, Canadian and Latin American Clients

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Tariff tangos

—
Dr. Pascal Köppel
Chief Investment Officer,
Vontobel SFA

Dear readers,

The month of February commenced with markets stepping into an orchestrated dance of quarterly earnings and economic policy moves that drove market sentiment in tandem.

Big Tech earnings exposed differentiation within the sector, with some tech giants like Meta and Microsoft reporting better-than-expected results, while others, including Tesla, faltered. The "old" economy stocks[1] were on a steadier footing, drawing attention to potential sectoral shifts. Interestingly, after two years of tech dominance, the Dow Jones Industrial Average has outpaced the Nasdaq Composite so far this year. This can be seen as an early sign that investors may be pivoting toward traditional industries and value-oriented stocks, likely amid concerns over lofty tech valuations.

Announcements about various potential tariff implementations also commanded attention, with an initial focus on Canadian and Mexican imports. A lot remains uncertain about the implementation, both in breadth, countries effected and level of tariffs, at this moment. Despite initial market jitters and a shift to safe havens like gold, investors largely tuned out the noise as the full scope remained uncertain.

We believe that, rather than being a permanent policy, tariffs appear to be a negotiating tool for advancing "America First" policies. We also do not expect most tariffs to endure for very long or not remain at current levels.

Investors are also closely monitoring prospects of a Russia-Ukraine ceasefire. A resolution could allow Trump to push Europe to increase their military spending while leading to a shift in US fiscal spending. This could also be a catalyst for Europe to adopt more fiscal stimulus. At the same time, reduced policy uncertainty could improve economic sentiment. Indeed, over the past week there were significant defense spending and infrastructure spending initiatives announced in Europe and especially in Germany.

The macroeconomic divergence between the US and Europe has narrowed. However, significant differences on product and labor markets still persist between the two regions. This is driving monetary policy divergency and creating more scope to loosen monetary policy in Europe while the Fed remains in wait and see mode. US inflation in January exceeded expectations, creating a more challenging path on the way to the Fed's 2 percent target. As we see it, a Fed rate cut in the first half of the year is unlikely, although factors like easing services inflation and slowing wage growth may help to contain price pressures.

The dance floor is crowded, but we aim to make every step count.

[1] Stocks from traditional industries like manufacturing, energy, transportation or consumer goods that can provide stable earnings, dividends, and long-term value.

—
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—
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Markets two-step around risks

Investors had plenty to juggle with last month, ranging from improving economic growth to shifting geopolitical tensions. We maintain our outlook for steady growth, moderate inflation and further central bank easing, which we believe should favor equities and bonds.

Trade war fears surged as headline after headline came in, such as levies on Chinese goods, or tariffs on all steel and aluminum imports as well as on cars, pharmaceutical and chips. However, if the first US-Chinese trade war is any guide, tariffs alone are unlikely to drive a sustained rise in goods prices. Higher inflation risks would instead have to come via US economic strength against a background of tight product and labor markets. This would take time to pass through. Although January's inflation came in hotter than expected, we do not see this as a lasting trend. Early-year inflation spikes are common, as companies often adjust pricing then.

Against this backdrop, we see room for some interest-rate cuts this year. Markets are cautiously pricing in 2 or 3 Fed cuts in 2025. The Fed will update its forecast (previously 50 bps) at the FOMC meeting in March. The European Central Bank (ECB) and the Swiss National Bank (SNB) may accelerate easing in response to Europe's weaker economy.

We continue to favor equities and bonds. Within equities, we think US stocks can benefit from policy changes, especially tax cuts, while AI related productivity gains will continue. We also prefer Swiss equities. Turn to page 5 for more details.

	UNDERWEIGHT significantly	UNDERWEIGHT slightly	NEUTRAL	OVERWEIGHT slightly	OVERWEIGHT significantly	
1 Liquidity	→					We are keeping a significant underweight in liquidity, as we see scope for bonds and equities to outperform versus cash.
2 Bonds				→		The outlook for high-quality fixed income remains supportive. We remain overweight in investment grade (IG) credit. We continue to prefer high-quality (investment grade) bonds and remain underweight in high yield credit. In our opinion, companies with weaker balance sheets and a greater reliance on external borrowing are more vulnerable, and their bond prices and spreads over higher-quality bonds do not sufficiently compensate for this risk.
3 Equities				→		We continue to maintain a medium overweight position in equities. The fundamental outlook for equities remains constructive overall. The key drivers of corporate earnings growth remain solid. Policy measures expected from the new US government will particularly support US growth and be positive for US equities. We remain tactically overweight in US equities versus cash and continue to be overweight in Switzerland against an underweight in the UK.
4 Commodities / Gold			→			We continue to hold a positive view on gold. The yellow metal rallied strongly in 2023 and 2024. Heightened geopolitical uncertainties and ongoing strategic purchases of gold, especially by central banks in emerging markets, remain positive drivers.

Changes month-on-month: same → higher ↗ lower ↘

Trade tariffs: likely a temporary negotiation tool

Tariffs are back in focus. This month's market highlights provide an assessment on the typical impact and how they are likely used now.

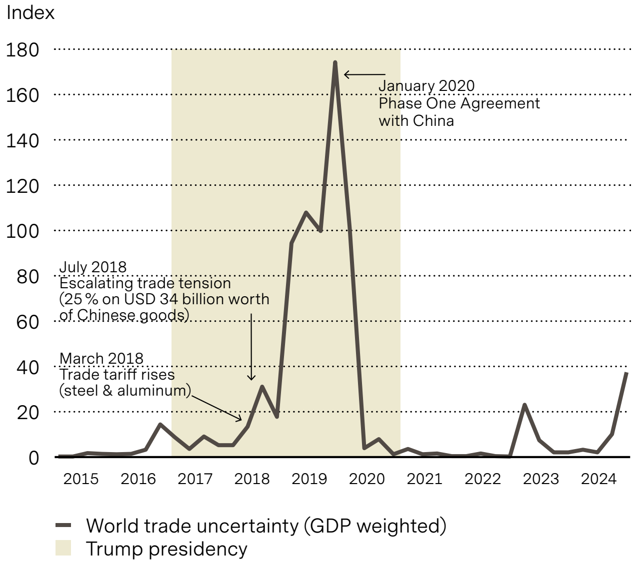
—
Dr. Pieter Jansen
Chief Investment Strategist,
Vontobel SFA

In January 2018, the Trump administration introduced a series of tariffs and trade barriers (see chart 1). Although China, the world's second-largest economy, was the primary target, other countries also found themselves in the crosshairs. The US imposed a 25 percent tariff on Chinese imports, triggering retaliation from Beijing. By January 2020, after two years of economic brinkmanship, both sides had brokered a Phase One trade deal, a fragile truce in which China pledged to increase US imports by USD 200 billion over two years.

The discussion on trade tariffs has reemerged. Once again, the focus is on countries running a trade surplus with the US (see chart 2). The latest round of tariffs began with announcements of duties of 25 percent on imports from Mexico and Canada, followed by a 25 percent tariff announcement on aluminum and steel and a 10 percent tariff on all Chinese goods. Additionally, a 25 percent tariff on cars, pharmaceuticals and semiconductor chips was proposed. Part of these have been implemented while parts were postponed, with significant uncertainty surrounding the implementation.

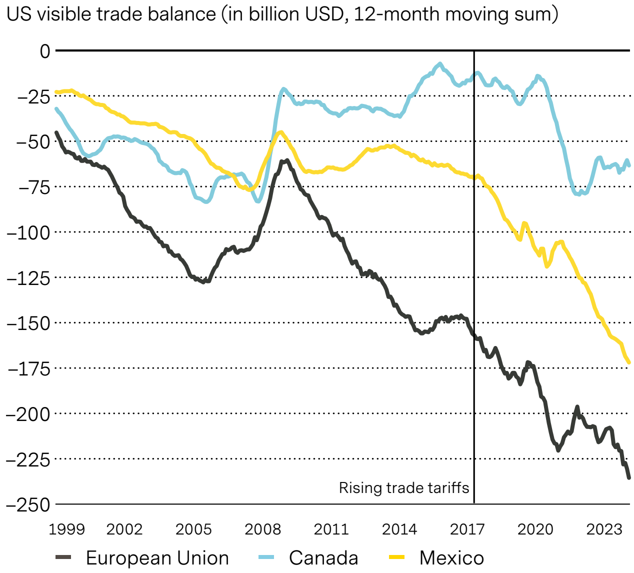
Many US presidents and other non-US governments for that matter have used tariffs in the past. What is the appeal of tariffs? We see three key reasons: first, tariffs can be used by governments as a source of federal income that can help reduce the US fiscal deficit and finance campaign promises. Second, tariffs can be used to provide protection to key national industries—whether by safeguarding US technological leadership in semiconductors or bringing back manufacturing jobs through "re-shoring" instead of "off-shoring". Third, (significant) tariffs can be used as a bargaining tool to advance broader

Chart 1: Trump put tariffs back on the political agenda in 2018



Source: LSEG, Vontobel; as of 4Q 2024.

Chart 2: The US is dealing with a major trade deficit



Source: LSEG, Vontobel; as of December 2024.

policy goals, such as fighting the fentanyl crisis or putting pressure on NATO allies to increase military spending.

Downside risks for the economy, limited upside risks for inflation

Although it is not our base case, escalating trade restrictive measures should make investors more concerned about (global) growth rather than inflation. Tariffs disrupt nearly every economic player, creating uncertainty for both businesses and consumers alike. If taken too far, companies may scale back investments and hiring, while consumers respond by cutting back on spending. This domino effect weakens corporate earnings, consumer demand and overall economic growth, potentially pushing the economy into a downturn. In such a scenario, any inflation concerns would largely "resolve themselves" as weaker demand cools price pressures.

Chart 3 shows that even the trade tensions in 2017–2020 had a marginal impact at best on US goods inflation. One exception was tariffs on washing machines and parts, which in some cases soared to 50 percent. However, even those prices started to fall again by the end of 2018.

In the short term, tariffs can create market volatility, but fail to deliver lasting economic benefits in the long run. The higher US imports that China pledged under the Phase One trade deal have yet to be fully realized. While COVID-19 and its impact on global trade played a role, they do not tell the whole story. Protecting certain products and sectors can have political benefits in an environment of rising geopolitical competition.

Economically, businesses in nations affected by tariffs often find ways to adapt, limiting the intended economic pressure. One method is to diversify export routes. For example, China's exports to developed markets have steadily declined, from nearly 60 percent before the trade war to about 50 percent by late 2024, while exports to other countries have surged (see chart 4). Trade has boomed particularly in countries like Vietnam (due to its proximity to China) and Mexico (due to its proximity to the US). Vietnam's trade surplus with the US reached a record high of over USD 123 billion last year. This represents an increase of nearly 20 percent.

Another common strategy is currency devaluation, which can help offset higher tariffs. While President Xi Jinping has repeatedly emphasized the need for a "stable" currency, a renewed devaluation remains a real possibility if trade tensions escalate.[2]

According to a poll conducted by public policy research organization, CATO Institute, 55 percent of Americans have a favorable view of international trade. 53 percent support free trade, while only 34 percent view tariffs positively. We believe the US administration's "maximum pressure" trade policy is less about tariffs themselves and more about leveraging trade negotiations to secure good deals on the issues that truly matter to voters, namely inflation, healthcare and the economy.[3]

Where will this lead us?

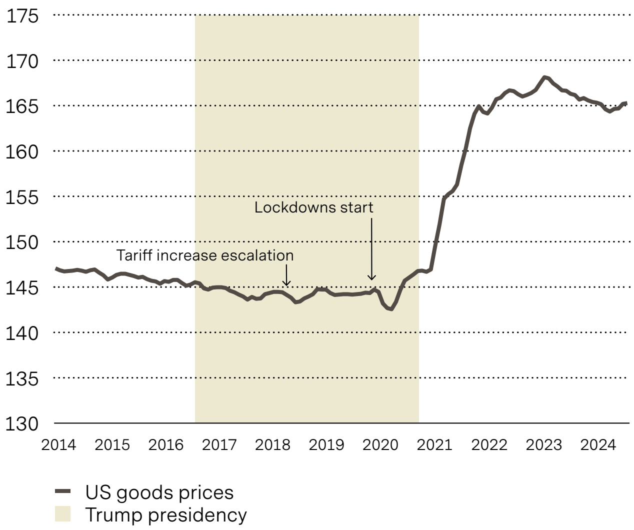
We think that the large and broad trade tariffs are primarily used by the US administration as a bargaining tool. We therefore do not expect that these high tariffs will be in place for the long run. While some tariffs should be there to stay, they will be more focused, for instance, on where they are relevant to US strategic geopolitical interests. In the meantime, investors have to look beyond the noise and focus on the fundamentals that drive economic growth and corporate earnings.

[2] The Chinese yuan is allowed to fluctuate 2 percent in either direction from a daily midpoint set by the central bank.

[3] Source: CATO Institute 2024 Globalization and Trade National Survey www.cato.org/sites/cato.org/files/2024-08/Globalization%20Survey_2024.pdf

Chart 3: Trump's first round of tariffs in 2018 had a limited impact on overall (goods) inflation

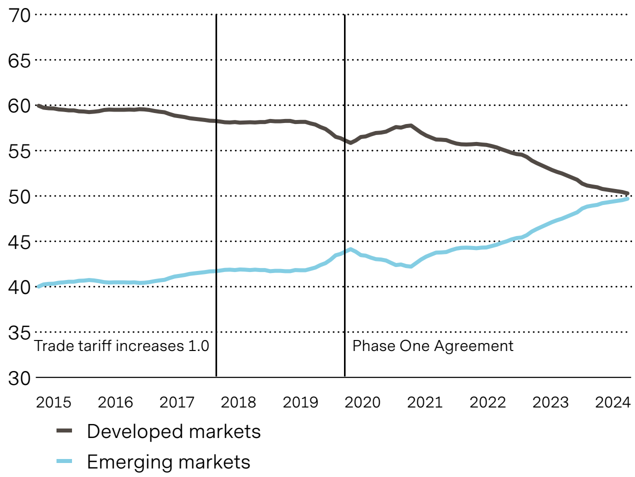
Consumer Price Index (CPI)



Source: LSEG, Vontobel; as of 4Q 2024.

Chart 4: Alternative export routes can offset the impact of tariffs

Chinese exports to … (in % of total exports)



Source: LSEG, Vontobel; as of 4Q 2024.

The Fed’s slow dance

—
Philipp Wartmann
Senior Investment Adviser,
Vontobel SFA

January’s Consumer Price Index report surprised on the upside, driving two-year and 10-year breakevens to multi-year highs. The longer-term inflation expectations remained steady, with the five-year, five-year forward inflation expectation rate[4] remaining steady. The Fed is meanwhile maintaining a cautious stance, demanding clear evidence of disinflation before cutting rates. Markets are pricing in 1.6 cuts or around 40 basis points (bps) for 2025, while the Fed’s guidance suggests a larger 63 basis point move however, the pricing of Fed rate cuts has become very volatile again.

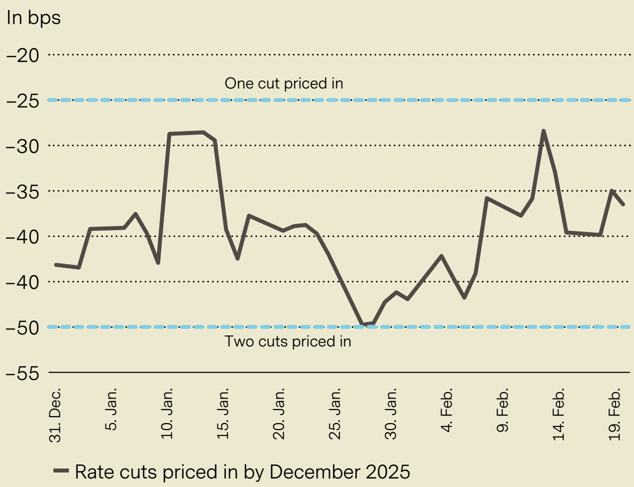
The January inflation update confirms an end to the disinflation trend, at least for now. Shorter-dated market-implied inflation expectations hit a two-year high. Meanwhile, the five-year, five-year forward gauge held steady but rising short-term expectations highlight how sticky inflation is. The data reinforces a patient stance by the Fed, with any rate cut hinging on clear, sustained progress toward its inflation target. As Chair Jerome Powell recently noted, the Fed doesn’t overreact to a few months of strong or weak data—nor should markets.

Market expectations for Fed rate cuts this year have fluctuated between one and two cuts (see chart 1), with 1.6 cuts (40 bps) currently priced in. Nearly two months into the year, seven FOMC meetings have yet to be held, with a March pause highly likely, May all but certain and June still a toss-up—leaving four “live” meetings for potential action. While markets expect 40 bps of easing, the Fed’s year-end median dot suggests a 63 basis point reduction could be on the table.

Corporate investment grade bonds
This bond segment continues to offer stability and attractive all-in yields in a slowing economic environment. Tight credit spreads (the yield pick up over government bonds) reflect strong fundamentals and improved companies’ balance sheets (see chart 2). Although spreads are still below their historical average, they continue to offer a reliable source of income, especially in sectors like US technology or EU utilities. Investors should focus on good quality credits with strong cash flow generation and low leverage.

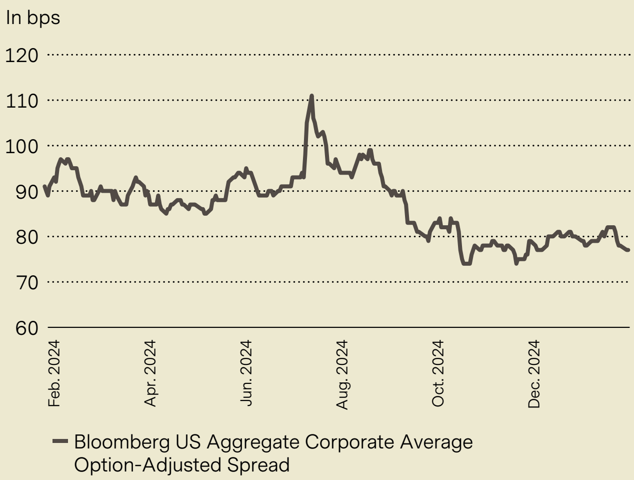
[4] The five-year, five-year forward inflation rate, which is derived from inflation swap instruments, is a key measure of market expectations for medium to longer term inflation.

Chart 1: Rate-cut roulette



Source: LSEG, Vontobel; as of February 19, 2025.

Chart 2: Spreads grinding ever tighter



Source: LSEG, Vontobel; as of February 19, 2025.

“Objects in the mirror are closer than they appear”

—
Markus Bruhin
Head Managed Solutions,
Vontobel SFA

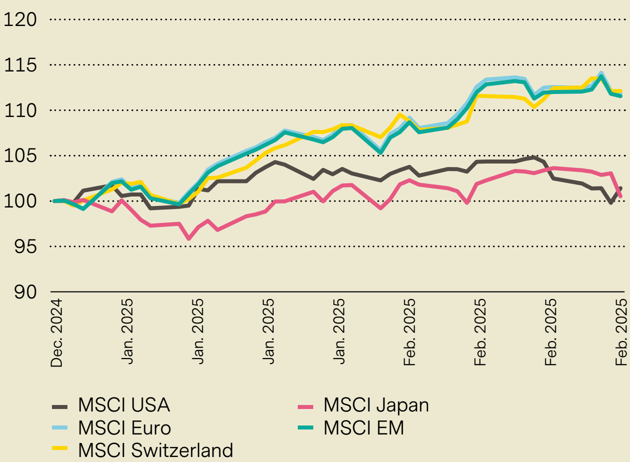
The familiar safety warning engraved on passenger-side mirrors—“Objects in the mirror are closer than they appear”—is a fitting analogy for China’s latest breakthrough in artificial intelligence (AI). DeepSeek’s game-changing development in January serves as a wake-up call, proving that despite setbacks, China is not gone from the global landscape.

The post-election exuberance for US equities appears to be losing steam amid weaker economic data and the post-DeepSeek AI capital expenditure reality check. The Nasdaq composite index is down 8.5 percentage points from its February 19 peak. Specifically, uncertainty over tariffs and government layoffs seems to be affecting the economy and consumer confidence took a dip last week. In addition to a decline in real consumer spending, home sales fell and jobless claims rose. While a recession in the near term remains improbable, it may no longer be unthinkable. Even decent earnings from the likes of Nvidia were not enough to propel equity markets higher. Sentiment among retail investors, who are heavy owners of AI/tech stocks, as measured by the AAII bull-bear survey, has collapsed to the lowest levels in more than two years.

On the other hand, European equities (including Switzerland) posted an exceptional outperformance at the start of the year (see chart 1), when they benefitted from investment shifts out of the US into the rest of the world (strong outperformance too by emerging market equities). This run was driven by short covering by hedge funds, some relief / hope on tariffs, positive news flows on a potential Ukraine ceasefire (until end of February) and a positive German election outcome. Results from the German election indicate that a two-party ruling coalition (CDU / CSU and SPD) is likely, which should improve decision-making and political stability. Although the path to reforming the debt brake is not straightforward, there is still potential for some fiscal easing, which likely augurs well for further inflows into Germany and Europe. Despite the significant outperformance, flows into European equities have been lackluster and only picked up in last few weeks. In general, investors seem to have taken profit on their US overweights and have reduced their underweights in Europe.

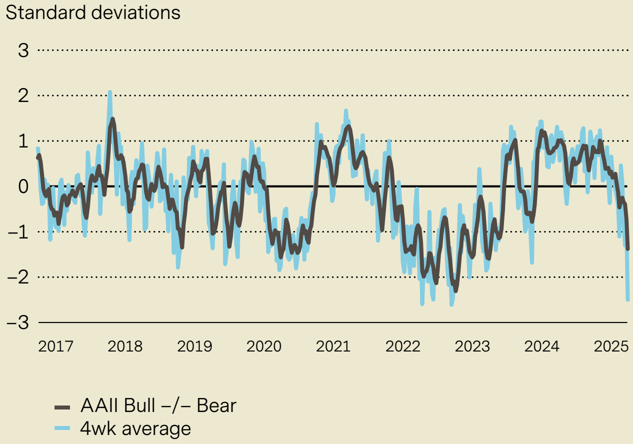
We remain moderately overweight in equities. Depressed sentiment in the US offers some cushion (see chart 2). Furthermore, Chinese authorities recently made a meaningful pivot in their rhetoric toward Big Tech and the private economy. This may imply a policy shift that is intended to unwind low local equity valuations and encourage inflows into China. It would also support European economy as trading relations between these two blocks would start gaining traction again.

Chart 1: Regional equity performance (in USD; end 2024 = 100)



Source: MSCI, Bloomberg, Vontobel SFA

Chart 2: US equity sentiment at very low levels



Source: Bloomberg, Vontobel SFA

Coffee—the new "black gold"?

—
Christoph Windlin
Deputy Head
Investment Management,
Vontobel SFA

While crude oil, on which the price of gasoline is based, has been trading in a comfortable range of USD 70 to 75 per barrel for months, the price of the coffee beans has been on a relentless upward trajectory.

The price of high-quality arabica beans, known for their smoother, less bitter taste, has surged by more than 100 percent since the start of 2024. Meanwhile, the price of robusta beans, typically used for instant coffee, has risen by over 90 percent(see chart 1). The primary culprit? The weather.

Brazil, responsible for nearly 40 percent of global coffee production and the largest arabica supplier, has been hit by a devastating mix of frost and prolonged drought. Extreme weather swings—drought followed by heavy rainfall—have also taken their toll in Vietnam, the world's second-largest producer and the dominant supplier of robusta beans. (see chart 2). As a result, crop yields have plummeted, leading to tighter supply. The situation is particularly acute for arabica beans, a staple for major coffee chains.

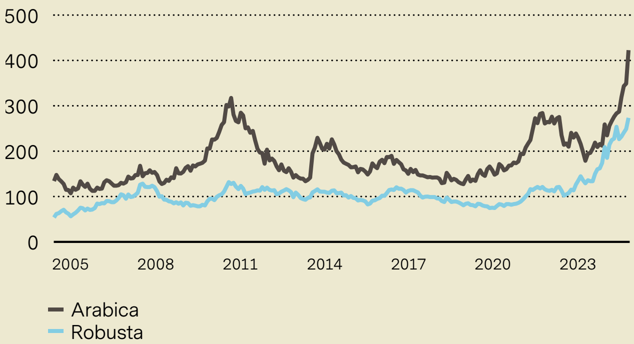
Further upward pressure came from a general rise in production costs, including higher transportation and labor expenses. There were also reports that some farmers have been reluctant to sell their beans, leading to speculation that prices will climb even further. More recently, geopolitical developments, such as the potential (temporary) threats of US sanctions against Colombia (which accounts for 8 percent of global coffee production), have also played a role.

In response to soaring prices, some coffee buyers have started switching from arabica to robusta, and major food companies are passing on costs to consumers. Despite this, demand for coffee remains strong. Coffee is either an essential daily staple or a luxury people refuse to forgo—depending on whom you ask. Unless harvests improve or consumers significantly cut back, the price rally could continue. For now, Brazil's crop forecasting agency, Conab, expects the country's coffee harvest to fall to 51.8 million bags in 2025/2026. This represents a 4.4 percent decline from the previous year. After Brazil, Switzerland is the largest coffee exporter[5].

[5] www.statista.com/statistics/1096413/main-export-countries-for-coffee-worldwide/#:~:text=Major%20coffee%20exporting%20countries%20worldwide%202023&text=In%202023%2C%20Brazil%20exported%20nearly,roughly%203.6%20billion%20U.S.%20dollars

Chart 1: The price of consumers' favorite pick-me-up drink has picked up

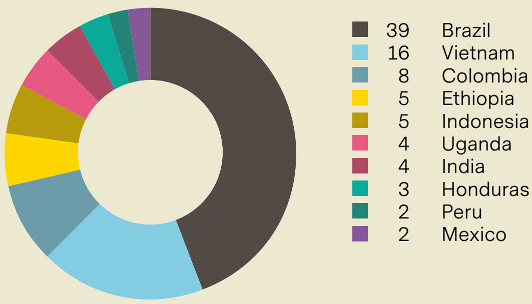
US cents per pound



Source: LSEG, Vontobel; as of February 21, 2025.

Chart 2: The world's biggest coffee-producing countries

2023/2024 coffee production (in %)



Source: US Department of Agriculture; as of 2023 / 2024.

Real US dollar near 40-year high: strength or strain ahead?

—
Dr. Pieter Jansen
Chief Investment Strategist,
Vontobel SFA

Although the nominal trade weighted dollar index has been weakening this year, the real broad dollar index, which corrects for inflation differences, has not. This trade-weighted real dollar index is nearing a 40-year high, driven by higher US interest rates, capital inflows and safe-haven demand. After years of stability post-2008, the US dollar surged from 2015 onward as US yields outpaced global peers, reshaping trade and investment flows.

The index measures the dollar's value against a basket of the major trading partners' currencies. Adjusted for inflation, it offers a more accurate picture of its purchasing power and competitiveness than nominal measures do. Currencies from countries with significant US trade ties carry greater weight in the calculation. As chart 1 illustrates, the dollar has climbed steadily over the past decade. Having remained range-bound following the 2008 – 2009 financial crisis, the dollar gained momentum from 2015 onwards, as the Fed raised rates while the ECB and the Bank of Japan held policy rates near or below zero. Higher US yields made dollar-denominated assets more attractive, reinforcing the currency's strength. With real dollar valuations approaching four-decade highs, attention is now on the impact on trade, investment and global financial stability.

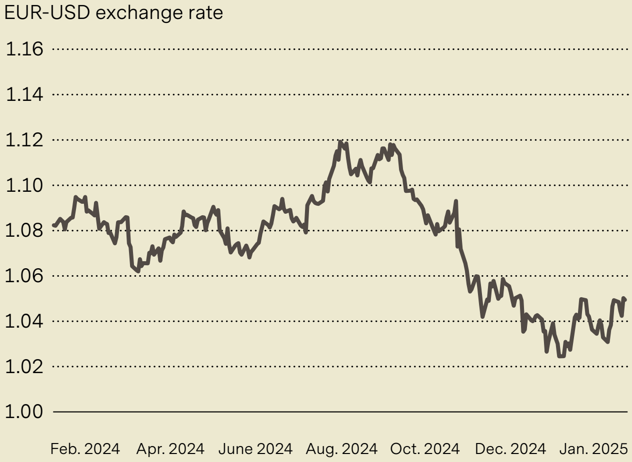
The dollar's short-term trajectory remains closely linked to tariff policy developments and economic momentum. While a hardline stance has historically supported the currency, the recent tough rhetoric is increasingly seen as strategic posturing, dampening its impact. Beyond trade uncertainty, economic fundamentals remain the strongest pillar of dollar strength. Optimism about US growth persists. Unlike in early 2024, when skepticism prevailed, early 2025 expectations favor continued US dominance—leaving the US dollar vulnerable to any signs of underperformance, which is a cyclical shift. Strategically, the rising trend in US debt and sizeable fiscal deficits combined with EM central banks trying to diversify their US dollar reserves are negatives for the long-term real dollar exchange rate.

The euro's rebound against the dollar (see chart 2) stems from a mix of factors, including dollar bull fatigue and lingering uncertainty around US trade policy. While tariffs remain a key risk, there is little clarity on how they will unfold. If the US proposed reciprocal, country-specific approach materializes, it could leave room for negotiation—potentially weakening the bullish dollar case. It is too soon to call a lasting euro-dollar trend reversal, as the move appears more driven by dollar weakness than fundamental euro strength. Optimism over a potential Ukraine-Russia ceasefire is another factor that could further support the euro if it materializes. A stronger euro-dollar in a risk-on environment may also lift other currency pairs.

Chart 1: US dollar approaches 40-year high in real terms

Source: LSEG, Vontobel; as of February 21, 2025.
Past performance is not a reliable indicator of current or future performance.

Chart 2: Euro rebound—dollar fatigue or a lasting shift?



Source: LSEG, Vontobel; as of February 21, 2025.
Past performance is not a reliable indicator of current or future performance.

Economy and financial markets 2024 – 2026

The following list shows the actual values, exchange rates, and prices from 2024, as well as consensus forecasts for 2025 and 2026 for gross domestic product (GDP), inflation / inflationary expectations, key central bank interest rates, 10-year government bonds, exchange rates, and commodities.

GDP (IN %)	2024[1]	CURRENT[2]	2025 CONSENSUS	2026 CONSENSUS
Global (G20)	3.2	2.8	2.6	2.6
Eurozone	0.7	0.9	0.9	1.2
USA	2.8	2.5	2.3	2.0
Japan	0.1	1.2	1.2	0.9
UK	0.9	1.4	1.1	1.4
Switzerland	1.3	1.7	1.3	1.5
Australia	1.0	0.8	1.9	2.3
China	5.0	5.4	4.5	4.2

INFLATION	2024[3]	CURRENT[4]	2025 CONSENSUS	2026 CONSENSUS	VONTOBEL VIEW IN 2025[5]
Eurozone	2.4	2.5	2.1	1.9	→
USA	3.0	3.0	2.8	2.6	↓
Switzerland	1.1	0.4	0.5	0.8	→

KEY INTEREST RATES (IN %)	2024	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS	VONTOBEL VIEW IN 12 MONTHS[5]
EUR (deposit rate)	3.00	2.75	2.10	1.82	→
USD (Fed funds rate, upper bound)	4.50	4.50	4.35	3.95	↓
CHF	0.50	0.50	0.20	0.20	→

GOVERNMENT BOND YIELDS, 10 YEARS (IN %)	2024	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS	VONTOBEL VIEW IN 12 MONTHS[5]
EUR (Germany)	2.37	2.46	2.34	2.34	↓
USD	4.57	4.42	4.44	4.32	↓
CHF	0.33	0.58	0.40	0.51	↓

FOREIGN EXCHANGE RATES	2024	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS	VONTOBEL VIEW IN 12 MONTHS[5]
CHF per EUR	0.94	0.94	0.94	0.94	↑
CHF per USD	0.91	0.90	0.91	0.90	↑
USD per EUR	1.04	1.05	1.02	1.05	↑

COMMODITIES	2024	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS	VONTOBEL VIEW IN 12 MONTHS[5]
Brent crude oil, USD per barrel	75	74	75	72	↓
Gold, USD per troy ounce	2,625	2,941	2,788	2,700	→
Copper, USD per metric ton	8,768	9,559	9,338	9,600	↓

1 Subject to revisions (e.g., potential revisions to 4Q data)
2 Latest available quarter
3 Subject to revisions
4 Latest available month, G20 data only quarterly
5 ↑ above consensus, → in line with consensus, ↓ below consensus

Source: Vontobel, respective statistical offices and central banks; as of February 24, 2025.

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