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May 2025

Monthly Perspectives
Optimal Income Strategies

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Assessing the Impact of Trade Tensions

- Trump's "Liberation Day" sends shockwaves through global markets
- High policy uncertainty calls for caution especially in the US
- Germany's strong finances offer a safer haven than the US outlook

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What's happening?

The aggressive escalation of US tariffs—well beyond what was factored into our baseline—has significantly darkened the global economic outlook. We now forecast global GDP growth to slow to 2.6% in 2025 and 2.4% in 2026, as trade policy uncertainty disrupts investment, trade flows, and business sentiment across major economies. The erratic and tactical nature of tariff implementation is likely to further amplify growth volatility in the coming quarters.

In the US, while we anticipate a modest rebound from a weak Q1, the broader outlook has deteriorated. We now expect GDP growth to slow to just 1.6% in 2025 and 0.6% in 2026, reflecting the drag from tighter financial conditions, weaker business confidence, and trade disruptions. The Eurozone is also set to feel the fallout, likely slipping into a mild recession in the second half of 2025, primarily due to a sharp decline in exports. Some relief may come from fiscal stimulus in 2026, but the path to recovery remains fragile.

China has mounted the strongest retaliation yet, with its globally integrated supply chains under strain. We estimate a 2.5 percentage point hit to GDP from current US tariffs, bringing growth down to 4.3% this year and 4.0% in 2026, despite Beijing's stepped-up efforts to support domestic demand. Emerging markets, meanwhile, remain particularly vulnerable—those with existing domestic weaknesses are being hit hardest by rising uncertainty and mounting global security tensions.

This deteriorating macro backdrop is expected to prompt further easing from major central banks. We expect the US Federal Reserve to begin cutting rates from June, with the policy rate reaching 3.75% by year-end and 3.25% in 2026. The European Central Bank is likely to move more aggressively, cutting to 1% by year-end, with a 50 basis point cut not entirely off the table. The Bank of England is expected to cut rates three more times this year and continue into 2026, ending the forecast horizon at 3.25%. The Bank of Japan, however, is unlikely to push ahead with further hikes amid growing global headwinds.

Source: AXA IM as end of April 2025

Positioning & Performance :

	GLOBAL OPTIMAL STRATEGY			OPTIMAL STRATEGY			DEFENSIVE OPTIMAL STRATEGY		
	Dec-24	Mar-25	Apr-25	*Dec-24*	Mar-25	Apr-25	*Dec-24*	Mar-25	Apr-25
Net Equity	*87,9%*	78,7%	65,4%	*76,3%*	69,8%	66,8%	*34,6%*	27,8%	24,4%
Equities	*79,7%*	71,1%	66,4%	*72,9%*	66,7%	64,3%	*37,0%*	32,9%	20,7%
Equities derivatives	*13,9%*	12,6%	0,0%	*5,2%*	5,5%	2,5%	*-2,4%*	-5,1%	3,7%
Risk Mitigation Strategies	***-5,7%***	**-5,0%**	**-1,0%**	***-1,8%***	**-2,4%**	**0,0%**	***0,0%***	**0,0%**	**0,0%**
Fixed Income	*5,0%*	10,5%	10,6%	*23,6%*	25,0%	24,9%	*62,9%*	50,9%	20,8%
Govies	*0,0%*	0,0%	0,0%	*0,0%*	0,0%	0,0%	*0,2%*	5,3%	7,7%
Bond Derivatives	*45,0%*	31,5%	28,5%	*27,4%*	25,7%	22,2%	*10,4%*	2,8%	37,7%
High Yield Credit	*1,0%*	2,3%	2,1%	*5,6%*	5,9%	5,4%	*16,3%*	6,9%	7,6%
Investment Grade	*3,9%*	8,2%	8,4%	*17,6%*	18,8%	19,1%	*46,0%*	38,4%	5,1%
Emerging Debt	*0,1%*	0,1%	0,1%	*0,3%*	0,3%	0,3%	*0,5%*	0,3%	0,4%
Diversification	*11,6%*	11,2%	7,9%	*2,2%*	2,2%	2,1%	*5,9%*	8,2%	8,8%
Cash & Money Market	*-4,4%*	-0,5%	16,0%	*-1,9%*	3,0%	6,3%	*-3,4%*	13,1%	46,0%

In April, in response to the sharp escalation in trade tensions following President Trump's so-called “Liberation Day,” we made several key adjustments to our portfolio to reduce risk and preserve capital in an increasingly volatile environment.

We reduced our exposure to global equities, maintaining a more cautious stance, as uncertainty around trade policy continues to weigh heavily on investor confidence, with limited visibility on the macro and earnings outlook.

Within equities, we further cut our allocation to US stocks, particularly small caps, which we view as especially vulnerable given their reliance on domestic demand, higher sensitivity to rising rates, and greater exposure to cyclical pressures. Instead, we have shifted exposure toward European equities—most notably German mid-caps, where we see more attractive valuations and a supportive backdrop driven by expected fiscal stimulus in infrastructure and defence.

On the fixed income side, we made a slight reduction in duration, while maintaining a preference for German Bunds, which we continue to view as the most attractive safe-haven asset in the current environment. Unlike US Treasuries, Bunds benefit from Germany’s strong fiscal position and remain supported by the European Central Bank, which still has room to ease policy further amid weakening growth and inflation. This combination of macro stability and defensive characteristics reinforces our conviction in Bunds as our preferred expression of duration in an increasingly fragile global landscape.

Regarding diversification, we continue to hold a positive view on commodities, with a particular focus on gold. Following gold’s all-time high in April, we took the opportunity to lock in gains by trimming our exposure.

Source: AXA IM as end of April 2025

Outlook

President Trump's self-declared "Liberation Day" marked a turning point — not for greater economic autonomy, but for heightened market anxiety. The sweeping implementation of broad-based tariffs, applied indiscriminately across nearly all trading partners, has introduced a level of policy uncertainty that markets are struggling to absorb. Far from a calculated strategy, the tariffs landed more as economic shock therapy, driving the effective U.S. import tariff rate to levels not seen since the 1930s. While the administration framed this move as a necessary step to reclaim industrial competitiveness, investors interpreted it as a disruptive policy misstep — one that underestimated the complexity of global supply chains and overestimated the economy's resilience to external shocks.

Market reactions have been swift and severe. Global equities lost trillions in market value within days, while typical safe-haven assets like U.S. Treasuries failed to provide meaningful protection. A partial 90-day pause in tariff implementation for most countries — excluding China — only underscored the unanticipated impact. More broadly, investor sentiment has shifted: traditional macroeconomic drivers such as growth, inflation, and earnings have been supplanted by the unpredictability of executive decision-making. The president's willingness to tolerate market stress as a means to assert U.S. leverage on the global stage has further eroded investor confidence.

The Federal Reserve now finds itself in an increasingly precarious position. Political interference, including repeated public pressure from the president and even discussions about removing the Fed Chair, has raised questions about the institution's independence. This, in turn, has begun to undermine the foundational assumption of Treasuries as risk-free assets. Investors, wary of policy dysfunction and credibility erosion, have rotated sharply into alternative stores of value. Gold, trading at historic highs, has become a key beneficiary, buoyed by both retail demand and aggressive central bank accumulation, particularly in Asia.

Equities, meanwhile, remain vulnerable. Despite the correction, valuations have not fully adjusted to reflect the deteriorating macro backdrop. Forward multiples remain elevated, even as consumer spending slows, corporate investment retreats, and earnings revisions turn negative. The key growth pillars — fiscal stimulus, services consumption, and tech-led capex — are all showing signs of fatigue. US small-cap stocks, in particular, are under acute pressure, given their reliance on domestic demand, sensitivity to rising rates, and limited financial flexibility. Tariff-driven inflation and rising long-end yields present additional challenges, further tightening financing conditions.

The current earnings season may provide pockets of support, with certain sectors like financials and consumer goods showing temporary strength. However, these effects are likely to be short-lived. Beneath the surface, corporate guidance is becoming more cautious, capital spending is declining, and forward visibility is shrinking. With valuations still rich, political risk rising, and confidence in key institutions under strain, the outlook remains uncertain. Crucially, the risk is not just cyclical — it is structural. Markets are beginning to reckon with the possibility that instability is no longer episodic, but embedded in the policymaking process itself.

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