PURE CAPITAL
INDEPENDENT ASSET MANAGEMENT

Written on May 5, 2025

MARKET OVERVIEW MAY 2025

By Dominique Marchese, Head of Equities & Fund Manager

A REVOLUTIONARY IN THE WHITE HOUSE

The month of April will undoubtedly go down in the annals of financial markets. Donald Trump's "liberation day" on April 2nd caused a severe drop in stock indices, a marked weakening of the dollar, and significant tensions on Treasury yields. In the minds of investors, the chaos unleashed by the announcement of stratospheric reciprocal tariffs against fifty-seven countries called into question, at least in part, the exceptionalism of the American economy and the attractiveness of its capital markets. Donald Trump was quick to react to the risk of a financial crash: his about-face on April 9th (suspension of reciprocal tariffs for ninety days except for those against China, with the minimum 10% tariff remaining in effect, along with other specific customs duties) and the appeasement shown towards the Chairman of the Federal Reserve allowed a return to calm. Despite the uncertainties, Wall Street has finally returned to its pre-Liberation Day levels.

TRUMP DOES NOT ACT WITHOUT A COMPASS

At the beginning of May, the level of the American stock markets is far from evoking a period of chaos and collapse of investor confidence in the fundamentals of the American economy. The main indices are down only 5% since the beginning of the year (in local currency), technology stocks around 10%, which, given the still high level of uncertainty, is not strictly speaking a catastrophe. The main global index has the luxury of approaching its level of January 1st; the European indices are recording positive performances! The situation is obviously a little more contrasted for investors who must endure the marked weakening of the dollar – in euros, the global index is down 8% since the beginning of the year, New York is down around 12%. **The market rebound since the about-face of April 9th is impressive** (nearly 15% for the main index of the New York Stock Exchange, 18% for technology stocks alone). **It reflects investors' conviction that the tariff war is only a transitional period,** that reason will eventually triumph, that no country can seriously question the benefits of free trade and the theory of comparative advantage of the famous British economist David Ricardo (1772-1823): the necessarily successful outcome of bilateral trade negotiations will lead to a widespread easing of tensions. In fact, the valuation of the financial markets is once again perfectly compatible with a growth rate of the global economy close to 3% per year, its pace in recent quarters, and an increase in corporate profits of 8 to 10% per year in the long term – at this stage, the scenario of a decline in profit margins is excluded. Still according to the consensus, the recession that could hit the United States would be only technical, the result of a sharp increase in precautionary imports before the possible increase in customs tariffs – which was already observed in the first quarter –, and the inevitable postponement of investments by entrepreneurs while waiting for more clarity. Consequently, investors should not attach too much importance to consumer and business confidence indices, which have certainly been very weak for several weeks, but which should recover quickly if trade tensions are not likely to permanently alter the fundamentals of the American economy. Here, summarized in a few words, is the state of mind of investors barely a month after "liberation day".

We can only rejoice in the investors' composure and placidity in the face of Donald Trump, a fan of chaos and maximum tension to force his interlocutors to bend. But have we fully understood the tragicomedy played out by an Administration with a keen sense of showmanship? The commonly accepted idea is that the White House finally backed down in the face of the collapse of Wall Street–60% of American households own stocks – and the tensions over Treasury borrowing. This consensus could prove to be wrong. For starters, Donald Trump successfully imposed the minimum 10% tariff, the highest level since World War II and compared to an average tariff of 2.4% before his presidency. Before "Liberation Day," the consensus believed that this 10% was negotiable and compressible; this is not the case! Second, investors never believed that Trump was a doctrinaire attached to a specific plan. However, the events of recent weeks seem to indicate, on the contrary, that the White House's plan is indeed to seriously challenge the US economic development model of the last fifty years, and this is truly surprising for observers accustomed to the immobility of the political class in Western democracies, whatever the short-term cost, including in the polls. Investors have never really taken Donald Trump's political program seriously–aside from promises of tax cuts and deregulation–nor the analyses deemed fanciful by his main economic advisors. Finally, criticism has multiplied regarding the amateurism of the new Administration, emphasizing in particular the far-fetched nature of the method for calculating reciprocal tariffs, which is nevertheless not without logic. As a reminder, the reciprocal tariff is calculated as half the ratio between a country's trade surplus with the

Pure Capital S.A., société de gestion régulée par la CSSF (Luxembourg)
www.purecapital.eu | info@purecapital.eu

Siège social Luxembourg
2 rue d'Arlon, L-8399 Windhof | T : +352 26 39 86

Succursale Belgique
Sneeuwbeslaan 20, B-2610 Wilrijk | T: +32(0)3 246 04 65

United States and its total imports from that country. This calculation aims to take into account not only the respective customs duties but also all protectionist policies that hinder trade in American products, for example environmental and technical standards. We recall that the 50% factor led Donald Trump to describe these tariffs as "nice." **What are the objectives pursued in this outright rejection of free trade, which has nevertheless been the compass of the global economy since the fall of the Soviet Union (Gatt trade agreements of 1994)? Indeed, the average tariff of 120% applied to China,** much higher than the theoretical calculation of 34%, and nevertheless excluding a few exceptions such as consumer and industrial electronics, **clearly announces the end of trade with this country. The Trump administration seems to forget that trade surpluses and deficits are not so much the result of tariffs as the implacable consequence of productivity differentials between nations.** The rather theoretical but particularly striking calculations, which went viral after "Liberation Day," on the hypothetical production cost of an Apple iPhone in the United States, much higher than that of its assembly in China, had the merit of reminding us of this obvious fact.

A FUNDAMENTAL CHALLENGE TO THE AMERICAN MODEL

It is interesting to note that the United States has long been criticized for its development model, which is considered unbalanced and unsustainable in the long term. Thanks to the "exorbitant privilege" of its currency (already singled out by Valéry Giscard d'Estaing in the 1960s, then French Minister of Finance), which guarantees its position as the world's leading economic and military power, **this country lives well beyond its means, as evidenced by the permanence of its twin deficits** (federal budget and trade balance). Its domestic consumption, financed by credit, **finds as a counterpart the purchases of dollar-denominated assets by non-residents and countries that accumulate trade surpluses,** such as China and Germany. To provide purchasing power to households, massive imports of goods produced in countries with low labor costs have long compensated for the low real wages linked to insufficient productivity gains (especially before 2022) – the same policy is found in Europe. **As long as the dollar is not threatened by any serious alternative in its status as an international currency (60% of the world's foreign exchange reserves), the model seems set to endure. However, it has not only had virtues.** First of all, the status of leading military power, which has acted as a reassurance for the Free World since the end of the Second World War–to the great benefit of countries that devote their budgets to financing the welfare state–means high public spending (defense still represents today about three times China's budget in dollars!), to the detriment of other needs of American society. Second, massive imports, particularly from China, have devastated entire industrial sectors and led to the impoverishment of the working class, Trump's primary constituency in the famous "Rust Belt." The weakening of the industrial fabric has led to an over-dependence of the United States on its trading partners, while China has decided to pursue a policy of competing power. This is particularly clear in rare earths (China), electronics assembly (China), and semiconductors (Taiwan). While China's exported deflation has certainly helped contain US inflation and, consequently, Treasury interest rates *at* reasonable levels, it has also fueled asset bubbles, financial instability, and contributed to increasing wealth inequality. **Donald Trump has clearly decided to challenge this development model, which has nevertheless helped attract foreign talent, preserve technological leadership, and ensure the extraterritoriality of US law.** The objectives seem at first glance contradictory and unrealistic: for example, lowering the dollar would result in higher real interest rates to continue attracting savings from the rest of the world (compensation demanded by non-residents against currency risk), but this is precisely what Donald Trump no longer wants, at least not in the form of purchases of Treasury bonds as compensation for partners' trade surpluses. In an increasingly threatening global geopolitical context, Trump is seeking to develop a resolutely autarkic model, in terms of energy – which is already the case –, in terms of industry and technology – by relocating production sites, since control of intellectual property alone is insufficient to counter China –, and via an accumulation of domestic savings – by a sharp contraction in public spending and a narrowing of the State's scope of action. **This is indeed a revolutionary project in the sense that, if carried out to completion, it represents a 180° turn from the existing model. In the short term, it is difficult to imagine that this can be done without pain for economic growth and corporate margins.**

ASSESSMENT OF ECONOMIC CONSEQUENCES

Assessing the long-term consequences of the Trump administration's policy seems impossible. Too many questions remain unanswered, particularly regarding the speed of its implementation, the outcome of trade negotiations and the extent of tariffs, the red lines it refuses to cross (initially), and also the influence that the upcoming mid-term legislative elections will have. At this stage, we can only share a few forecasts from the economic analysis firms consulted. Given the uncertainties surrounding tariffs after the suspension period decided on April 9, the ranges of estimates are wide. According to Berenberg economists, the failure of negotiations would lead US economic growth to slow by more than 1% in the long term, reaching +1.4%; if Trump lowers his threats, potential growth would be +1.6% (compared to +2% previously). In the shorter term, the probability of a US recession has increased significantly (50% according to JP Morgan); The growth loss is around 1% over twelve months, according to the consensus. Europe would only lose 0.3% to 0.5%, but should benefit from the German recovery plan in 2026. However, beware of the risk of submersion of Chinese products that will seek new commercial outlets – Shein, Temu and electric car manufacturers are the great symbols of this threat to European industry. Given its exports to the United States representing around 2% of its gross domestic product (GDP), China should see its growth reduced by 0.5% to 0.9%.

If the average tariff applied is 10%, the global economy will not collapse; it will be able to absorb the shock. However, we can ask ourselves the question of corporate margins in this uncertain context. During the pandemic, companies demonstrated their ability to manage tensions in supply chains and to pass on rising costs to final prices, even more so when demand, artificially supported by stimulus plans, far exceeded available supply. Profit margins had experienced an

Pure Capital S.A., société de gestion régulée par la CSSF (Luxembourg)
www.purecapital.eu | info@purecapital.eu

Siège social Luxembourg
2 rue d'Arlon, L-8399 Windhof | T : +352 26 39 86

Succursale Belgique
Sneeuwbeslaan 20, B-2610 Wilrijk | T: +32(0)3 246 04 65

impressive increase, fueling stock market indices (and also inflation, let's not forget). What will happen in the coming months? For investors, this is undoubtedly one of the most relevant questions. How will companies absorb disruptions in value chains (*pricing power*)? How will they deploy their investments? Will they relocate or relocate to the United States? How will margins evolve in this chaotic environment? We will have the answer very quickly, in the next quarterly publications. The only thing we are sure of at this stage is that the valuation multiples of stock market indices, especially those of the United States after the rebound, are indefensible if profit margins enter a downward cycle in the face of final demand weakened by economic uncertainties. As an illustration, without adopting a worst-case scenario (assumption of zero earnings growth in 2025), applying the average multiple of the last ten years (18) to 2024 profits would give the main index of the New York Stock Exchange a theoretical target 20% lower than the current level! **Currently, the consensus expects an increase in US corporate earnings of 9.5% in 2025, a very slight contraction compared to the end of March (-2%), which seems optimistic.**

CONCLUSION

Only a well-balanced allocation can navigate the current period of uncertainty unscathed. April is seen by many as a harmless episode for the dynamics of global economic growth. Quite the contrary, the White House has demonstrated its determination to turn the tables and seriously challenge, despite the consensus in favor of free trade, the organization of world trade and the United States' development model. Will Donald Trump slow down before the midterm elections or accelerate while he controls all the levers of power? He has placed action at the heart of his policy, which distinguishes him from many Western leaders accused of inertia and weakness. Moreover, his goal of restoring American productive capacity demonstrates his commitment to a long-term vision (several years to replace imports with American products), which does not seem to frighten him and contrasts with the "short-termism" that usually serves as a compass for the leaders of the Free World. It is hard to imagine that he could stop in the middle of the ford.

Pure Capital S.A., société de gestion régulée par la CSSF (Luxembourg)
www.purecapital.eu | info@purecapital.eu

Siège social Luxembourg
2 rue d'Arlon, L-8399 Windhof | T : +352 26 39 86

Succursale Belgique
Sneeuwbeslaan 20, B-2610 Wilrijk | T: +32(0)3 246 04 65