Citi Wealth

CIO Strategy *Bulletin*

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Investors seek foreign ports during US trade storm

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- **Despite some initial positive headlines around tariff negotiations with Japan, tariff risks – particularly sectoral – are increasing:** Sectoral tariff reviews for pharma/semis and reciprocal tariff negotiations are only now getting underway. Many of the countries facing high tariffs don't have the resources of Japan or the EU to commit to buying more US energy or goods. Moreover, while ostensibly remaining open to talks, for now, the Trump Administration appears to be trying to isolate China, publicly stating that reciprocal tariff rates negotiated with other nations might be influenced by those countries' willingness to curb their own trade flows with China.
- **Monetary policy is still not coming to the rescue**: Chairman Powell noted that it is "too soon to say" when asked for the Fed's assessment of the impact of trade policy. Critically, there is no real precedent for the current proposed tariff regime. Powell will respect both sides of the dual mandate, but for now is primarily focused on inflation, which lessens the chance of any near-term rate cuts.
- **Cross asset volatility has spiked in 2025:** While US Treasury volatility subsided somewhat during the week (as discussed further below), US equities closed lower. Gold jumped another 3% in the week, continuing a remarkable 26% YTD gain. Major foreign currencies such as the Euro and Yen also continued their YTD appreciation vs the USD, accelerating higher since "Liberation Day" (April 2nd) (see **FIGURE 1**). It's likely that investors are reallocating a portion of their US investments abroad due primarily to weaker US equity market return expectations. But these flows may also be in part anticipating that sharply reduced expected global net trade flows into the US will result in smaller capital flows to "recycle" back into the US. Non-US equities have also outperformed US counterparts (see **FIGURE 2**), as have German sovereign bonds (Bunds) relative to US Treasuries.
- **Our view**: We expect market volatility to remain high, and headline driven. We do not expect a rapid de-escalation of the tariff negotiations, so corporate earnings visibility will remain very low. Equity positioning and technicals could lead to dramatic market swings, but we are remaining focused on fundamentals – and both the forward earnings and macro growth outlooks are deteriorating. Given that risks remain for the Treasury yield curve to steepen, we continue to favor short to intermediate bonds.

FIGURE 1: Yen vs euro vs gold YTD

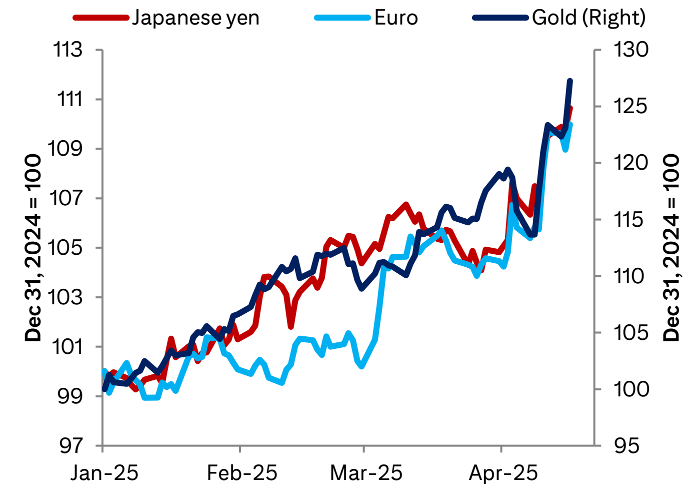
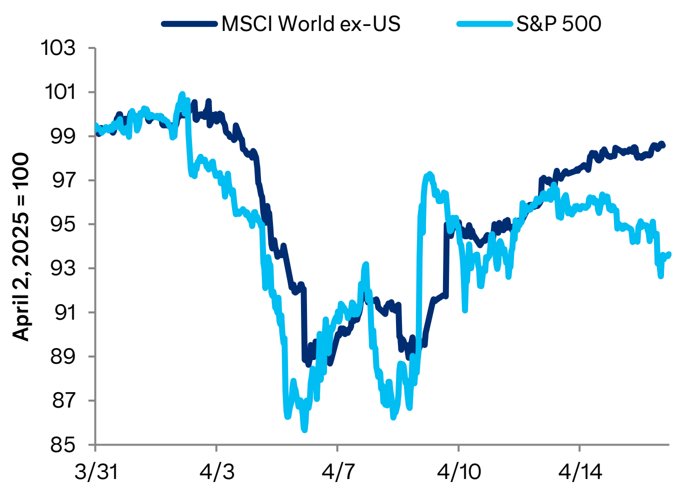


FIGURE 2: International shares vs S&P 500 since April 2nd



Source: Bloomberg as of April 16, 2025. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary.

Fixed income recovers

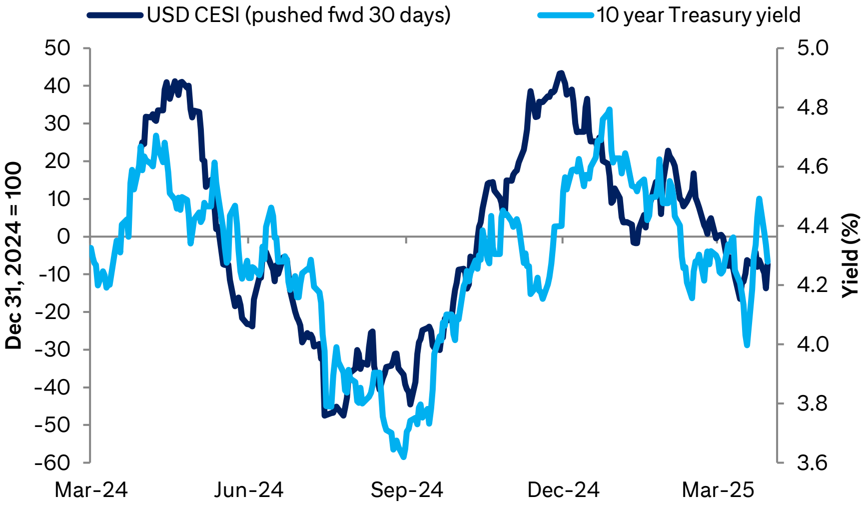
Following reassuring comments from Treasury Secretary Bessent, members of the Fed, and Chairman Powell, the Treasury bond market resumed its more characteristic "safe haven" function as yields fell, resuming its tracking of weaker economic news with about a month lag (see **FIGURE 3**). Notably, Chairman Powell indicated that the Fed was likely to emphasize for now the inflation portion of the Fed's dual mandate, noting that the economy "*can't have a strong labor market without price stability.*" In effect, the Fed remains in "wait and see" mode and is in no rush to cut rates.

Powell also noted that while ***current*** levels of federal debt "*are not at an unsustainable level*", it's "*better to address the debt situation sooner rather than later*" as the path of federal debt growth is unsustainable. These comments appeared to be a comment on market concerns over the current US budget negotiations and possibly higher future deficits. S&P rating agency echoed this view on Monday, when it said in a report: "The outcome of the US government's budget process and policy negotiations over the coming months will help determine policies that inform our view of US sovereign creditworthiness."[1]

Given the Fed's reticence to cut rates near-term, longer-term Treasury rates are unlikely in our view to drop much further given uncertainty over future inflation, the possibility of an increasing US budget deficit, and potentially declining future foreign demand for longer maturities. In addition, as we highlighted in yesterday's Data Watch, comments this week by President Trump about his dissatisfaction with Chairman Powell and the Fed's unwillingness to lower rates will be closely monitored by the market. Should this situation escalate beyond words towards an active effort to remove the Fed Chair prior to his term expiry in May of 2026, bond investors would likely be even less inclined to own longer-dated Treasuries for fear that any new Fed chair might steer towards overly stimulating growth by cutting rates too deeply. We maintain that fixed income portfolios have a short to intermediate duration range (3-5 years) and maintain an "up in quality" bias in overall portfolio construction.

[1] S&P Global, U.S. Fiscal Trajectory Hinges On Budget And Policy Outcomes, April 14, 2025.

FIGURE 3: 10yr UST yield vs Citi Economic Surprise Index (pushed forward by 30 days)



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Investment Grade			
Highest quality	Aaa	AAA	AAA
High quality (very strong)	Aa	AA	AA
Upper medium grade (Strong)	A	A	A
Medium grade	Baa	BBB	BBB
Not Investment Grade			
Lower medium grade (somewhat speculative)	Ba	BB	BB
Low grade (speculative)	B	B	B
Poor quality (may default)	Caa	CCC	CCC
Most speculative	Ca	CC	CC
No interest being paid or bankruptcy petition filed	C	D	C
In default	C	D	D

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- restrictions on transferring interests in the Fund;
- potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized;
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- less regulation and higher fees than mutual funds; and
- manager risk.

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