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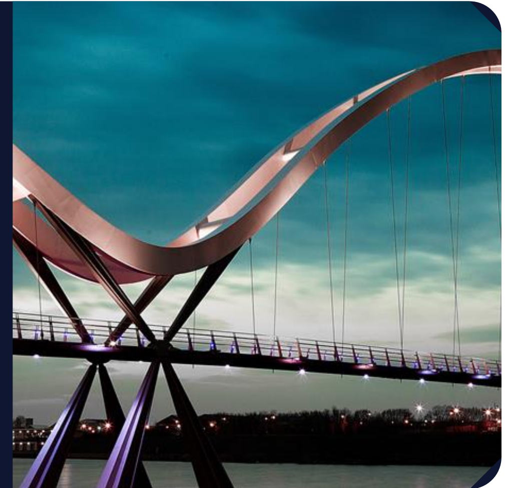
Citi Wealth

Investment Strategy *Bulletin*



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Increasing economic uncertainty leads to decreasing investor risk appetite

A week of escalating trade tension spilled over into financial markets

- In a week characterized by historically sharp equity selloffs and a brief, but historic, rally, “safe haven” assets failed to provide portfolio ballast. The yields on long-duration Treasuries moved sharply higher while the USD weakened against global currencies. Investors sent a clear signal that given increasing levels of economic uncertainty they would prefer to reduce their level of risk.
- The root cause of this uncertainty was the US following through with its pledge to impose extremely high individualized “reciprocal’ tariff rates the morning of April 9th on imports from the rest of the world, and then that very same afternoon surprising markets by revising down the tariff rates for all countries (except China) to 10% for 90 days (sectoral tariffs on steel, aluminum, autos, and non-USMCA goods from Canada/Mexico were not revised lower, however).
- Even as the US signaled a willingness to engage in negotiations with some countries, the trade tension between the US and its third largest trading partner, China, reached a fever pitch. As of this writing, and after several retaliations on each side, Chinese exports to the US face a tariff rate of 145%, while China’s tariff rate on US imports is 125%.
- Policy-induced market volatility remains extremely elevated as investors turn their attention to 1Q25 earnings. Several big banks and financial institutions that reported early on Friday cautioned that activity is likely to slow amid ongoing trade and economic “turbulence.” We will continue to monitor changes in corporate guidance and noted that several consumer bellwethers including Delta Airlines and Walmart pulled guidance earlier in the week. Citi believes that current EPS estimates (~+10% on-year) for FY2025 are improbable.

Bottom Line

The world is in the early stages of a global trade realignment. As we highlighted earlier in the week, although we may be past the peak tariff shock, we do not expect a rapid de-escalation or near-term resolution that will sustainably buoy corporate, consumer, or investor sentiment. The crisis of confidence borne from dramatic policy changes will likely curtail economic activity, and we expect downgrades to earnings estimates over the course of the reporting season that kicked off today. We continue to stress patience for investors looking to deploy cash in this volatile market and we reiterate our call that this is not yet an attractive time to add to risk. Investors should consider shoring up portfolios with less correlated assets and structures that can generate income while limiting downside.

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Your Questions Answered

Q: US consumer confidence is falling rapidly, and many CEOs in the US see a recession coming. Couldn't the US just negotiate a lowering of tariffs for US companies and the whole issue will blow over?

A: The "good" news of the past week is that the Trump administration has signaled it is open to negotiate trade deals. This might lower prospective tariffs from the highest levels feared. However, President Trump has derided non-tariffed trade as unfair, "ripping off the United States" since at least 1987 (PBS). We should expect President Trump to hold fast to that view and expect some higher level of US tariffs over the long run.

Making tailored trade deals country-by-country for the US is a demonstration of executive power in which Trump is very active. Unfortunately, this approach leaves great uncertainty about the rules of the world trading system's largest economy. This will chill even domestic business investment. It is likely to have a lasting negative impact on confidence in the US economy from foreign business leaders and investors. A 90-day reprieve to 10% for all countries except China (merely shifts the tariff burden sharply towards China to a level that will likely dramatically curtail trade. Even the non-China tariff increases are historically massive and sectoral tariffs remain. More sectoral tariffs may also be announced, for example on pharmaceuticals.

While financial markets are moving quickly to assess the likely negative economic consequences of the tariffs, we believe it will take time for the full impact to unfold. For example, the impact on US employment might not be entirely felt until well into 2026.

Q: What risks are investors missing? Is this just about tariffs and trade?

A: Far from it. Numerous vulnerabilities get tested when policymakers shock the economy, resulting in unintended consequences. What has been called "Trade War 2.0" has much of the world focused on painful retaliation steps against US firms. The tariffs will result in a reduction in US demand for imports through price hikes, substitution of products, and reduced demand. This will slow global growth with certain economies that are particularly reliant on exports to the US (Canada, Mexico and Vietnam are examples).

The economies that are weakened by the US trade shock will have reduced resources to trade with other economies and periods of trade weakness typically coincide with declines in business investment, employment and corporate profits (see Quadrant). The shock – of whatever scale - also transmits to business and consumer credit quality. This negatively impacts domestic businesses and banks, even those not closely linked to trade to some degree.

We are monitoring how the sharp spike in policy uncertainty can drive down market liquidity. While relatively mild so far, for the first time since the onset of the COVID pandemic in 2020, the US Treasury market experienced selling pressure even as the economic outlook darkened. (We see this impact distinct from the period of Federal Reserve tightening in 2022 which also drove up bond yields). This shows "deleveraging" pressure to sell highly liquid assets to make margin calls, including some complex trades. US Treasuries are considered the highest quality collateral for borrowing and therefore, permittable leverage is higher.

The willingness of foreign buyers to add to US Treasury holdings is another question. While the scale of US rate pressure is modest thus far, if US borrowing costs rise *while* the economy slows, it magnifies the effective tightening of financial conditions that weakens the economy.

Other global risks overlap this concern. The People's Bank of China is possibly limiting its intervention to stabilize the yuan. Declines in China's currency have historically resulted in large downward lurches in regional currencies that are not "managed" with market intervention. This can also spark "deleveraging" of portfolios which can impact markets.

Q: What are investors supposed to consider at this time?

A: There can only be one correct market view over a particular timeframe. But even if one knew it with accuracy, it does not provide a single answer for what every investor should consider. It depends on the investors' particular risk tolerance and level of market exposure, among other factors.

We continue to express caution about how markets and the economy will unfold. In time, investable market dislocations will be identifiable with greater confidence.

One area where the Global Investment Committee has increased our overweight is Investment Grade debt. We have diversified somewhat more globally in high-quality government bonds while cutting riskier credit. Short-term US Treasury yields of 3.92% are about 180 basis points above their 25-year average as of April 11, 2025. Intermediate Investment Grade US corporate debt yields about 5%, or 75 basis points more than the asset class's 25-year average yield. Short-term Treasuries, in particular, can be "dry powder" for a period when clearer equity market opportunities arise, especially during periods when equity and longer-term bond market volatility increases (see Figures 1 and 2).

FIGURE 1: 10-Year US Treasury Yield and US Bond Market Implied Volatility

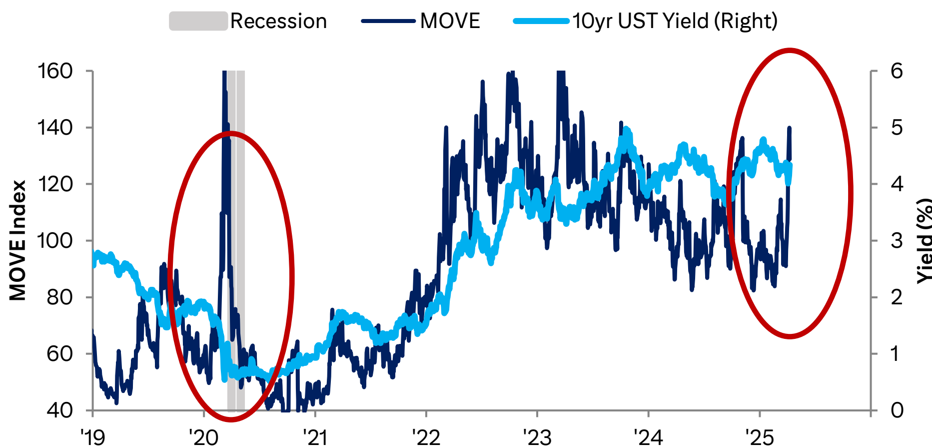

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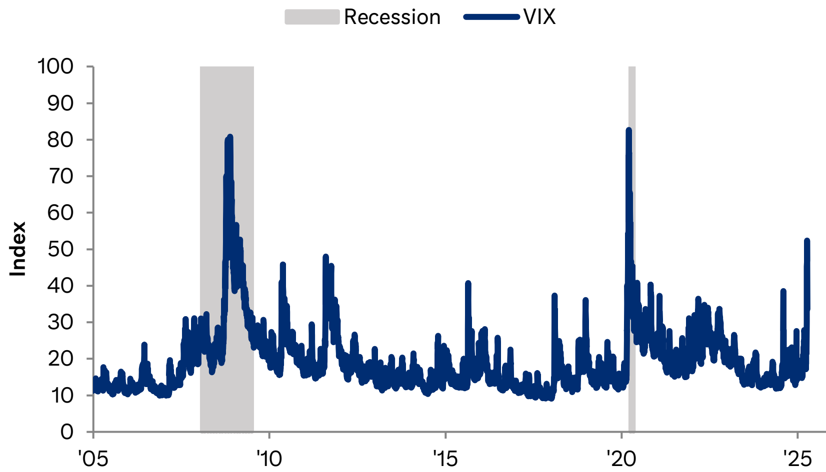
FIGURE 2: US Equity 1-Month Implied Volatility



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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

1 The ratings from Aa to Ca by Moody's may be modified by the addition of a 1, 2, or 3, to show relative standing within the category.
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- lack of liquidity in that there may be no secondary market for the fund and none is expected to develop;
- volatility of returns;
- 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;
- absence of information regarding valuations and pricing;
- complex tax structures and delays in tax reporting;
- less regulation and higher fees than mutual funds; and
- manager risk.

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