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INVESTMENT STRATEGY QUARTERLY

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Letter from the Chief Investment Officer

Markets on the Clock

It's draft season for professional sports teams in the United States! From American football to hockey to basketball, teams are gearing up to enhance their squads, while athletes strive to boost their value and become key contributors. Although the excitement of draft night is undeniable, the drafting process starts long before the player's name is announced to an enthralled audience, and the true impact of a player may not be evident for years. Similarly, the investment world and portfolio construction share many parallels with the drafting process. So, let's explore our investment strategies through the lens of drafting.

Before draft night, athletes showcase their skills through drills like the 40-yard dash, vertical jump, and strength tests. Team scouts analyse these metrics, along with psychological evaluations, to gain an edge in drafting the best players. This multi-faceted process is analogous to our economic analysis, as the US economy forms the foundation of investment decision-making on the western shores of the Atlantic Ocean. Despite a few near-term headwinds, the US economy remains resilient, and we do not see any signs of a recession developing.

However, with a new "sports chief", the Trump administration, implementing fresh ground rules, there has been a significant uptick in uncertainty for both consumers and businesses. The main concern is economic policy uncertainty, especially regarding tariffs. While tariffs are expected to have a slight negative impact on economic growth and inflation in the near term, we anticipate avoiding the worst-case scenario of a 20% effective trade-weighted tariff (up from 2.5% at the beginning of the year). The final rate is likely to be around 10%. Additionally, later this year, avoiding the expiration of tax cuts and benefiting from deregulation should help support growth.

Due to the one-time impacts of a harsh flu season, cold winter, and accelerated company imports to avoid tariffs, we are reducing our 2025 US GDP forecast from 2.4% to 1.8%. While lower, this outcome is far from catastrophic. Healthy job growth, robust consumer spending, continued AI investment, and a Federal Reserve poised to cut interest rates twice this year should keep the economy performing well. Our analysis suggests that the soft patch in the first quarter is likely temporary, with growth reaccelerating for the remainder of the year. These insights from our economic "scout team" guide our decision-making as we maintain constructive, positive views on most asset classes.

Now, the moment everyone has been waiting for: the first pick of the 2025 Investment Strategy Draft is in. The Investment Strategy team selects… US equities! Our reasoning is that the recent decline in the equity market has made valuations more reasonable, and we have high confidence in the corporate sector's ability to grow earnings, especially with the addition of emerging stars from the artificial intelligence (AI) sector. We view the recent Tech sector weakness as a temporary setback, not reflective of the sector's strong fundamentals. While tariffs are expected to impact GDP by 0.6%, potentially lowering our corporate earnings estimate by ~1% to $265-$267, this still represents robust earnings growth of 10-11% in 2025. There may be more volatility ahead, but with solid corporate fundamentals, we stand by our 6,375 forecast and recommend using any periods of weakness as buying opportunities. If our target is achieved, the equity market will have rallied by double digits between now and the end of the year. Historically, the equity market has provided the best long-term performance among the major asset classes for building wealth.

Despite a challenging start to the year, we've decided to hold steady and not make any adjustments within our favoured sectors: Information Technology, a highly skilled and potentially game-changing sector; Industrials, a reliable all-around player; and Health Care, our other selection with high potential. From a market-cap perspective, we continue to prefer stocks in US medium-sizedcompanies over smaller counterparts, although we continue to watch the latter as they need more time for the economy to develop further and for short-term interest rates to fall before becoming primary targets in our draft selections.

We're resisting the temptation to switch our preference from the US

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equity market to international equities, although some tout European equities as the next great market to rebound. However, our US analytics suggest that, whilst Europe is not unattractive, company fundamentals remain generally in favour of US equities, with greater earnings growth, profitability, less exposure to tariffs, and more dominant businesses in the sectors we prefer, especially Technology. Additionally, the US has a better educational infrastructure, greater entrepreneurship, and significantly lower taxes compared to Europe. These dynamics should keep investment money flowing to the US and help maintain its premium valuations. Despite their significant outperformance year-to-date, emerging market equities have fallen down our draft selection list as they have yet to reflect the potential negative impact of increased tariffs. Caution remains prudent in the near term. Remember, sometimes it's the hype-induced trades that you don't make that benefit the team (and portfolio) in the end.

As the squad selection process progresses, the excitement tends to fade until the last player is chosen, often called "Mr. Irrelevant". While being the last pick may not seem glamorous, this nickname is a misnomer, as many players selected in that spot have gone on to become incredible contributors to their teams. In today's market, we believe the US bond market deserves the title 'Mr. Relevant.' After years of record low interest rates, with the 10-year Treasury yield briefly trading below 1%, the recent uptick in interest rates across the maturity spectrum has increased the income bonds can generate. Additionally, bonds have served as a diversifier and risk mitigator during the recent volatility across equity markets, just as they have done consistently through time. The big question is whether the anticipated lifting of the US debt ceiling this summer will cause a surge in government issuance that sends borrowing costs dramatically higher. We do not think so, as demand for government bonds remains healthy among retail investors, foreigners, and pension funds. Despite modest downward revisions to our economic outlook, we reiterate our 4.5% year-end 10-year Treasury yield forecast and would use any increases in yields above our target to extend duration. But with the yield curve very flat, investors can remain patient. Our top picks in the bond market remain the high-quality sectors: Treasuries and investment-grade bonds.

While US professional sports squad selections last just a few days, in the investment world, we're always on the lookout, hunting for insights to build your portfolio. Pundits might try to grade sports squad picks immediately, but true success is revealed only years later. Tom Brady, arguably the best American football quarterback in history, was the 199th pick in the 2000 draft. Similarly, there are no guarantees in the near-term performance of any asset class. That's why a long-term perspective is crucial, allowing your portfolio to gel like a well-coached team. Short-term, panic-driven decisions rarely help your overall goal. With volatility on the rise, maintaining the right asset allocation, a diversified portfolio, and a long-term horizon is key. Winning championships and successful investing both require strategy, patience, and resilience. Just as a championship team is built over time with careful planning and execution, a strong investment portfolio grows through disciplined decisions and a long-term vision. Remember, while you're the owner of your portfolio, let your adviser play the role of head coach, using their expertise to help you construct it. As basketballer Michael Jordan wisely said, "***Talent wins games, but teamwork and intelligence win championships.***"

Be patient and focused on the long term.

Lawrence V. Adam, III, CFA, CIMA®, CFP®
Chief Investment Officer

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The Five Key Themes to Watch in the Second Trump Administration

Ed Mills, *Managing Director,* Washington Policy Analyst, Equity Research

Amidst an aggressive start to his second term, we are monitoring a series of themes affecting the market impact of the Trump presidency. Among the key themes we are watching are president Trump's use of executive power, the playbook used in advancing his priorities, the upcoming fiscal fights in Congress changes to the regulatory environment, and how market moves may influence tTrump's decision making and action.

The cadence of executive actions at this stage in the US administration is unprecedented, President Trump signing executive orders and memos to direct activities across key issues including the border, trade, deregulation, energy, technology, and federal funding.

EXECUTIVE POWER

The cadence of executive actions at this stage in the US administration is unprecedented, President Trump signing executive orders and memos to direct key activities across key issues including the border, trade, deregulation, energy, technology, and federal funding. The imposition of new tariffs during the second Trump administration has largely been through the novel application of existing presidential authorities, and he has sought to use these authorities to pursue policy concessions from foreign trading partners aggressively whilst attempting to generate new federal revenues as part of the broader government funding debate—which includes cuts to federal spending.

On the issue of federal spending, we see the forthcoming debate over 'the power of the purse' to be a signature debate of 2025, likely decided by the Supreme Court. The Constitution gives Congress the 'power of the purse' (i.e., the authority to dictate federal funding/appropriations levels), while existing

statute limits the ability of the president to restrict or rescind appropriated funds. The administration has sought to test executive authorities in this area through the issuance of memos withholding funding and agency closures, which have been quickly met with legal challenges. The activities of the Department of Government Efficiency (DOGE) are another key issue to monitor on this front.

In 1974, after a battle over federal funding with the Nixon administration, Congress passed an Impoundment Control Act, which limits the ability of a president to restrict (impound) funding appropriated by Congress. This law will be tested in this fight, potentially establishing new parameters of executive power related to the distribution of appropriated funds.

THE TRUMP 2.0 PLAYBOOK

Several of President Trump's second-term actions to date have revealed a pattern that is likely to characterise many of the policy fights of the next four years. The President Trump frequently makes bold policy announcements that serve to move the political goal posts and expectations for policy outcomes. These bold announcements elicit pushback and / or raise concerns regarding unintended consequences. Frequently the final outcome is more diluted than that initially proposed.

Given this playbook, in many cases items 2 or 3 on the agenda will ultimately be what is implemented.

FISCAL FIGHTS

The pending expiration of the 2017 Tax Cuts and Jobs Act (TCJA) (i.e., the tax changes from the first Trump administration) will be a core vehicle through which many of the top Trump agenda items will be passed into law. With the individual tax rates implemented by the 2017 law expiring at the end of the year, Congressional Republicans have begun the process of extending the individual provisions of the TCJA, implementing new tax exemptions, and authorising $300 billion in defence and border spending through the budget reconciliation process. The specifics of the reconciliation bill (which allows Congress to pass fiscal legislation with a simple majority and avoid the 60-vote Senate threshold) have been and will continue to be a moving target, but our base case remains that the individual provisions will be extended—potentially on a permanent basis.

A key part of this debate will be the extent to which Congressional Republicans reduce federal spending to offset the cost of extending the 2017 tax cuts and increased spending on defence and immigration. Under the House-passed resolution, Republicans are targeting the

> President Trump frequently makes bold policy announcements that move the political goal posts and expectations for policy outcomes.

reduction of up to $2 trillion in spending over the next decade. The details are still being debated, but in a document circulated for input, reductions in Medicaid, student loans, and subsidies from the Inflation Reduction Act (which funds clean energy programs) are among the changes that represent the largest dollar amounts.

Additions to the TCJA that are being promoted by President Trump and are likely to be added to the bill include no tax on tipping, Social Security, and overtime. Increases to the $10,000 cap on state and local taxes and the revival of corporate tax incentives supporting R&D and capital expenditure are also likely additions.

The need to increase the debt ceiling, following the expiration of the current debt ceiling suspension in January, is a live issue to watch. We expect the X-date (when the government can no longer fulfil its debt service obligations using 'extraordinary measures') to fall sometime in late spring/early summer. The closer Congress approaches the X-date without raising the debt ceiling, the higher the headline risk and associated market volatility. House Republicans included a $4 trillion increase in the debt ceiling in their budget reconciliation proposal and the need to lift the ceiling before the X-date may prove to be a catalyst to finalise the reconciliation process.

FUNDAMENTAL SHIFTS IN THE REGULATORY LANDSCAPE

President Trump has promised an aggressive deregulatory agenda in his second term. While he pushed for deregulation in his first term, the lasting impact was less than initially expected. In his second term, changes ushered in by the Supreme Court and the creation of DOGE are likely to produce greater outcomes. In the last few years, several Supreme Court decisions have made it easier to challenge existing regulators (or place restrictions on regulators) as they develop new rules. These decisions will help usher in a more robust deregulatory agenda in the President's second term. We view these changes as most likely to impact on heavily regulated industries, such as financials, healthcare, energy, and telecommunications.

Central to the administration's deregulatory agenda has been the

establishment of DOGE (led by Mr Elon Musk), which examines federal spending agency by agency. President Trump has expanded the scope of DOGE beyond cost-cutting, to include a review of federal agency workforces and the function of federal employees. During this examination, DOGE is expected to seek reductions in activities of regulatory agencies it views as outside the statutory scope of the agency—which would usher in a reduction in regulatory infrastructure.

Turning to antitrust matters (laws regulating the concentration of economic power to prevent companies from colluding on pricing or the creation of monopolies), personnel appointments are shaping policy direction. The nominations of Gail Slater as DOJ Antitrust AAG nominee, Andrew Ferguson as FTC Chair, have signalled a shift from the antitrust enforcement seen during the Biden administration. The firing of two Democratic commissioners, which is being challenged in the courts, raises questions regarding the future of the FTC as a functional agency. While scrutiny of 'Big Tech' is expected to continue, according to the statements of the nominees and the effort to remove the Senate-confirmed Democratic commissioners, this raises other questions on the future activities of the antitrust evolution.

Turning to the financial sector, President Trump's re-election has triggered the largest changeover among federal regulators in US history, with personnel driving policy across agencies. Changes at the Department of the Treasury, Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and Consumer Financial Protection Bureau (CFPB) are ushering in a deregulatory agenda. The actions we have followed include the shelving of draft rules that would have raised capital standards for the banking industry and removal of guidance that added scrutiny to the approval process for bank mergers. With this change, we anticipate increased bank M&A activity, particularly among community and regional banks.

WHAT IS THE 'TRUMP PUT' IN TRUMP 2.0?

During his first term, there was much discussion in financial markets about a potential 'Trump put' on the stock market. The idea behind this discussion was that President Trump would monitor the stock market reaction to his policies and if the market reacted negatively, he would adjust or reverse course accordingly. The volatility clearly apparent in markets following the tariff announcements has raised the question: what exactly is the 'Trump put' in his second term?

According to statements from President Trump and Treasury Secretary Mr Scott Bessent, the preferred indicator for gauging the economic impact of administration policies is the 10-year Treasury yield. The 10-year Treasury yield is an important financial instrument that has a significant impact on the price of credit for consumers. Mortgages and other consumer loans are priced based upon this benchmark. When the yield goes up, credit becomes more expensive. When yields go down, the cost of credit becomes less expensive.

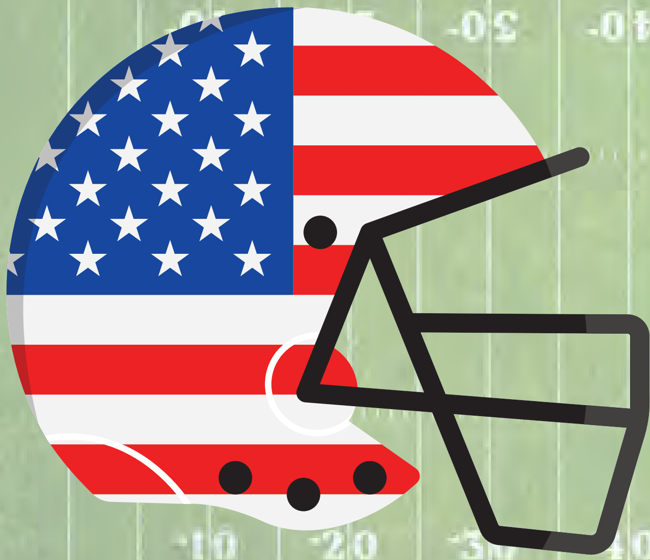
Seen from the perspective of Washington DC, the 10-year Treasury also reflects expectation of economic growth as well as the trajectory of government debt and spending. The efforts of DOGE to cut spending and the potential to collect more revenue through tariffs could be arguments to support lower yields. Conversely, higher debt projections from extending the 2017 tax changes (without budget offsets) and the potential negative economic impact of tariffs could cause yields to rise.

Should President Trump and Treasury Secretary Bessent use Treasury yields as a key barometer of success, that could force some moderation to policy.

The aggressive start to his second term has made the policy decisions of President Trump a driving force of market sentiment and volatility. While we expect the 2017 tax changes to be extended and a more robust deregulatory agenda, the use of executive powers and the ability for President Trump to singlehandedly dictate key policy outcomes will add to market volatility in 2025.

KEY TAKEAWAYS

- Among the key themes we are watching are President Trump's use of executive power, the playbook used in advancing his priorities, the upcoming fiscal fights in Congress, changes to the regulatory environment, and how market moves might influence the President's decision making and actions.
- We see a debate coming over 'the power of the purse '. This could be the signature debate of 2025, likely decided by the Supreme Court.
- President Trump frequently makes bold policy announcements that reset the political goal posts and expectations for policy outcomes. These bold announcements are often "walked back" resulting in the final outcome being less than initially proposed, but also more than originally expected.



Tariffs, Deportations, and Deregulation

Eugenio J. Alemán, PhD, *Chief Economist,* Raymond James
Giampiero Fuentes, CFP®, *Economist,* Raymond James

In 2025, President Donald Trump's administration is taking bold steps in three key areas: tariffs, deportations, and deregulation. The reinstatement of the 25% tariff on steel and aluminium imports aims to protect American industries from unfair trade practices while generating increased federal tax revenues. Simultaneously, mass deportations have intensified, with significant economic and social impacts, particularly in regions with large undocumented immigrant populations. On the regulatory front, a new executive order mandates the elimination of ten regulations for every new one introduced, aiming to reduce bureaucratic burdens and stimulate economic growth. These measures reflect the administration's commitment to reshaping the US economic landscape, though they have sparked considerable debate and controversy.

TARIFFS

President Trump's tariff threats have been a hallmark of his trade policy, aimed at addressing what he perceives as unfair trade practices by other countries. During his first term as president, he imposed tariffs on $380 billion of imported goods, including solar panels, washing machines, steel, and aluminium. At the time, these actions led to retaliatory tariffs from affected countries but had a small impact on US GDP growth. However, in the current term, the potential impact is likely to be more meaningful. In fact, as of the time of this writing, the president has imposed tariffs on imports from major trading partners like China, Canada, Mexico, Europe, and other countries, arguing that these measures are necessary to protect American industries and jobs, as well as to obtain better trade deals by pressuring countries into reducing their tariffs on US goods.

Note: The authors penned this article before President Trump's tariff announcements on 2 April 2025, which will impact global economies. The ramifications of these US tariffs will continue to be assessed.

In 2024, the effective US tariff rate was ~2.5% and we believe that's likely to increase to ~7.5% – 10% as we believe the Canada and Mexico tariffs will not remain in place for the long haul. From a top-down perspective, we expect US GDP could be reduced by as much as 0.6%-points resulting from a 5%-points increase in US average tariffs. On the other hand, we believe that for each 1% increase in the effective tariff rate, we could see inflation increasing by 0.1%-point, mostly driven by three items: food (including

vegetables and meats), energy, and transportation, which combined make up one-third of the entire CPI index.

DEPORTATIONS

President Trump began emphasising deportations early in his political career, frequently discussing cracking down on illegal immigration and deporting millions of undocumented immigrants in the 2016 presidential campaign. During his first term, over two million people were removed according to the Department of Homeland Security (DHS). Fast forward to 2025: President Trump has enacted numerous executive orders, deployed additional troops on the border, revoked temporary protections from deportation, and more. While these actions have made headlines, the reality is that at the time of this writing, there were only ~20,000 deportations according to the DHS, which are a small fraction of the 11 to 13 million illegal immigrants estimated to be in the country.

However, we believe that President Trump's mass deportation plans could be delayed, as there are significant legal, logistical, and financial barriers. Firstly, the Trump administration is already facing several legal barriers, ranging from pushback on birthright citizenship to being sued over the fast-track deportation policy. Secondly, there are numerous logistical barriers, such as the large backlog of current immigration cases, which stands at 3.6 million and the lack of manpower required to arrest 1 million people a year.

Deportation Financial Barriers

Cost to arrest: **$6,736**

Cost to detain: **$12,023**

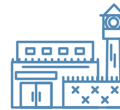
Cost of legal process: **$1,719**

Cost of removal: **$1,479**

Total cost for **one** undocumented immigrant: **~$20k**

Average cost over ten years if **10 million** immigrants (out of the estimated 11-13 million) are deported:

~$200 billion



Currently, the US only has enough detention space for fewer than **50,000** immigrants.

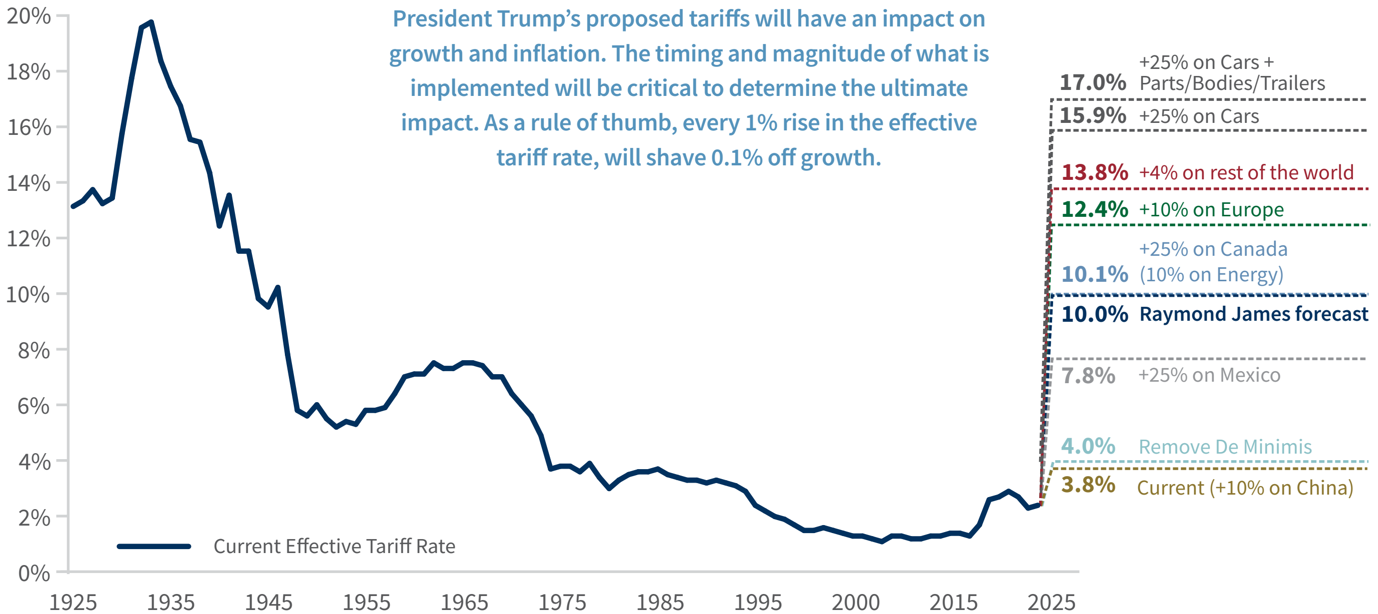
Cost to build **216** new facilities: **$66B/year**

Maintenance cost for **one** facility: **$47M/year**

10-year cost: ~$1 trillion

Sources: American Immigration Council and U.S. Immigration and Customs Enforcement

Effective Tariff Rate Will Rise When Tariffs Are Implemented



Source: FactSet

Lastly, there are significant financial barriers as shown in the infographic on the previous page.

DEREGULATION

Correctly approached, deregulation is one of the policies that has the highest potential to generate higher investment as well as higher productivity across industries. Higher investment and higher productivity would tend to increase the economy's potential growth. The recent increase in investments and/or commitments to invest in artificial Intelligence (AI) is one of those potentially transforming investments that will drive the US economy during this century and into the next century.

However, deregulation's effects are also very difficult to measure. Although firms across many industries are always complaining about being overregulated, some of the worst crises over the last several decades, i.e., the Savings and Loans crisis in the 1980s, the "Dot.Com" bust in the early 2000s, the Great Recession in 2008, etc., have been partially blamed on the lack of an effective regulatory environment.

In a number of industries, more regulation may be the price to pay for some government protections. This is the case in the banking industry, which is protected due to the important role it plays in 'lubricating' the US economy. The defence industry is also regulated and highly protected due to its vital role in US security. However, governments often tend to overregulate and reducing or making these regulations more efficient and less onerous on companies could lower costs and increase efficiency.

The most important argument for deregulating has to do with lowering the costs of doing business in an industry because it induces competition and enhances productivity. However, tariffs tend to just do the opposite, as they increase barriers to entry into an industry and render that industry less competitive. Thus, there is a trade-off between the imposition of tariffs and the drive for less regulation, which policymakers must be aware of when implementing policies.

BOTTOM LINE

Tariffs have had negative impacts on economies, increasing costs of goods imported and the costs of doing business. However, we believe that even if there were to be a reduction in economic growth, the US economy will still likely grow close to its potential output of 1.8% in 2025. On the other hand, higher tariffs are likely to lead to higher prices, but unless trade wars escalate, the inflationary impact should be contained and—most importantly—temporary.

> The most important argument for deregulation has to do with lowering the costs of doing business in an industry because it induces competition and enhances productivity.

From a deportation perspective, we believe there are several risks surrounding inflation and the labour market, but we also believe those fears are overblown, as mass deportations are unlikely to occur to the extent that was originally expected. Additionally, while advancements in AI are unlikely to replace construction and agricultural workers, they are likely to replace higher-paid workers while releasing some to look for new opportunities in other industries.

Deregulation has the highest probability of making the largest impact on economic activity as it reduces barriers to competition and improves efficiencies, which tend to increase productivity.

KEY TAKEAWAYS

- President Trump's administration is taking bold steps in three key areas: tariffs, deportations, and deregulation.
- The impact of tariffs is likely to be greater now than in the first Trump administration.
- The effective tariff rate could move from ~2.5% to ~7.5% to 10% resulting in a decrease in GDP from our 2.4% target to trend (~1.8%). Inflation could also increase, mostly driven by food, energy and transportation which together make up a third of the CPI basket.
- Deregulation is one of the policies that has the highest potential to generate higher investment as well as higher productivity across industries. Higher investment and higher productivity would tend to increase the economy's potential growth.

UK Stock Market Resilience In A Challenging Environment

Prof Jeremy Batstone-Carr, *European Strategist Raymond James Investment Services*

In a world of uncertainty, the UK stock market has proved remarkably resilient. The index of 100 largest quoted companies hit an all-time high in early March, shrugging off prolonged domestic economic weakness, the vagaries associated with US trade and tariff implementation, and seemingly insouciant to ongoing issues associated with Ukraine and the evolution of European defence policy. Although the benchmark index has pulled back from peak levels, the attraction for investors remains undiminished. Numerous constituents continue to generate strong cash flows, supporting dividend yields and share buybacks helpful in support of an attractive valuation, particularly against the more highly rated US. At the sector level and in common with European counterparts, a steepening gilt-edged yield curve (rising longer-dated borrowing costs) has proved a boon to the heavily weighted financials sector while industrials are benefiting from the government's pledge to increase defence spending.

SPRING STATEMENT HIGHLIGHTS ECONOMIC FRAGILITY

The stock market was unmoved by Chancellor Ms Rachel Reeves' 26th March economic and fiscal policy update. The world is changing, and the UK is not immune to the associated challenges. Given that the fiscal rules are sacrosanct, a necessary condition to prevent an even more aggressive rise in borrowing costs and that key elements of taxation have, for now, been ring-fenced, the brunt of the tightening in fiscal policy was achieved through a planned squeeze on government spending. The plans restore a £9.9bn headroom "buffer" against the rules which sounds substantial but is in fact both comparatively small and highly vulnerable to potentially adverse shocks. The independent Office for Budgetary Responsibility calculates that a widespread US goods import tariff of 20% could wipe it out completely. The uneasy conclusion is that bigger challenges lie ahead. Non-defence spending can only be cut so far, while the unhealthy concoction of weak economic activity (confirmed by a GDP growth forecast cut from 2% to just 1%) and still high interest rates means that borrowing can only rise so far. Next autumn's Budget could prove a key flashpoint.

TARIFFS

For all the hysteria surrounding the Trump administration's trade policies the key point is that the UK is comparatively insulated, reflected in the Trump administration's relative leniency. The White House is most exercised by those countries that run a big goods trade surplus with the US and the UK is not one of them. UK / US goods trade is broadly in balance, US-bound exports accounting for just 2.3% of GDP (well below Germany's 3.7%) and even if concessions are not secured the direct adverse hit might amount to as little as 0.1% of GDP. That being said, while the overall impact might be small there would be an adverse impact on, in particular, vehicle manufacturers and the pharmaceutical industry.

What is unclear at this time is what the indirect impact of tariff implementation might have on confidence and activity more generally. In that context it remains an open question as to what concessions (or carve-outs) might be forthcoming, perhaps in response to a commitment to buy more US-made goods such as oil and LNG (liquified natural gas) or armaments procurement.

DEFENCE SPENDING

The Chancellor endorsed Prime Minister Sir Keir Starmer's pledge to increase defence spending from 2.3% of GDP to 2.5% by 2027 (funded initially through a reduction in overseas aid). Beyond the short-term the government aims to increase spending to 3.0% of GDP between 2029 and 2033 (estimated cost £19.5bn a year by the end of the period) subject to economic and fiscal conditions permitting. That's a big caveat and could mean either that election pledges not to increase taxation, cut essential public spending or a tweak to the fiscal rules might have to be countenanced. It is estimated that the impact of increased spending on defence on GDP could be quite small, especially were spending on US military equipment to form part of a future trade agreement. However, any increase in borrowing might add to the financial market's already elevated concerns regarding debt sustainability, potentially causing gilt-edged yields to rise even further.

THE BANK OF ENGLAND

The interest-rate setting Monetary Policy Committee has cut the base rate three times, from 5.25% to 4.50%, but despite that, rising gilt-edged yields have not made an appreciable difference to borrowing costs for both households and businesses. Furthermore, in response to inflation still well above the 2% target and price pressures rising, including household bills, companies' National Insurance Contributions and a higher minimum wage, the Bank's policy statement includes a newly inserted line to emphasise that it is not on a pre-set path to lower interest rates. The economy may be weak and vulnerable but persistent inflationary pressures are likely to limit the Bank's room to provide much of a helping hand.

STOCK MARKET PROSPECTS

Despite much near-term uncertainty, an uncertainty the stock market has done well to shrug off thus far, prospects are much brighter. A lingering concern on the part of many corporate sector senior executives is that the UK equity market's persistently low valuation (in place since the UK's decision to leave the EU) fails to recognise the potential value inherent in many business models. This has resulted in numerous companies being bought out and taken private. But help could be at hand. The UK scores highly on AI (artificial intelligence) innovation and adaptation and the government's planned "Silicon Valley" between Oxford and Cambridge within a decade could spur the growth of a highly rated industry more than capable of filling the gaps left by departing businesses, galvanising renewed interest from investors both at home and from overseas.

KEY TAKEAWAYS

- The UK stock market has proved resilient, in no small measure due to reliable corporate cash generation and sustainable dividend yields.
- The UK economy is beset by numerous challenges both domestic and international. The vulnerability of the public finances was all too obvious at the Chancellor's March update.
- Near-term issues surround US trade policy, its impact on the economy and what might be done in response, including the prospect of higher defence spending.
- Despite the uncertainty the medium term outlook for both the economy and stock market could receive a boost from AI innovation, a field in which UK expertise scores highly.

A Turning Point For Europe

Prof Jeremy Batstone-Carr, *European Strategist Raymond James Investment Services*

Prospects for the Euro Area have been transformed in the space of a few short weeks following President Trump's inauguration on 20th January. Prior to that the outlook might broadly have been described as "low growth, low inflation and lower interest rates". Investors' attention was elsewhere, interest in the single currency area's financial markets limited to speculators betting, correctly as it turned out, that the US president's election victory in November last year might trigger Ukraine war peace initiatives promised on the campaign trail. Complex as delivering a lasting settlement in Ukraine will clearly be, Euro Area leaders are now actively addressing a second front, how best to respond to the implementation of aggressive trade tariffs, another of President Trump's initiatives. Developments are taking place at a breakneck pace, forcing member states and Brussels to evolve policy at lightning speed and financial markets, normally comfortable in pricing the future, are being forced to adjust on an almost daily basis to persistent uncertainty.

PARADIGM SHIFT IN GERMANY

Speaking at the Munich Security Conference in mid-February, US Vice-President Mr JD Vance made clear to a shocked audience that Europe could no longer rely on continuing US commitment to the North Atlantic Treaty's Article 5 security umbrella. For decades, questions relating to European defence had been relegated to a secondary consideration, but overtures between Washington DC and Moscow have added to the sense of urgency, forcing a series of high-level regional summits focusing on achieving agreement as to how best Europe might defend itself and specifically how such defence might be funded. But while region-wide discussions are ongoing, Germany has taken the lead.

A hastily reconvened Bundestag (lower house) prior to newly elected members taking their seats for the first time following late February elections, has achieved the necessary two-thirds "super majority" to overhaul the country's constitution allowing for reform of the so-called "debt brake", a strict fiscal rule imposing a ceiling on new borrowing to finance any increase in defence spending. In consequence as much as €500bn has been freed up over an unspecified period for national defence and other infrastructure projects. Unlike other fiscally constrained states, 20 years of austerity has left Germany's debt / GDP ratio at just 62.9%, comfortably the lowest across the G-7 industrialised economies. The decision has galvanised the euro, the single currency's gain against the US dollar one of the largest on record. German government bonds haven't hung around either, prices falling sharply and yields rising both in anticipation of increased issuance and investors' knee-jerk response to nothing short of a transformation in the entire region's economic prospects.

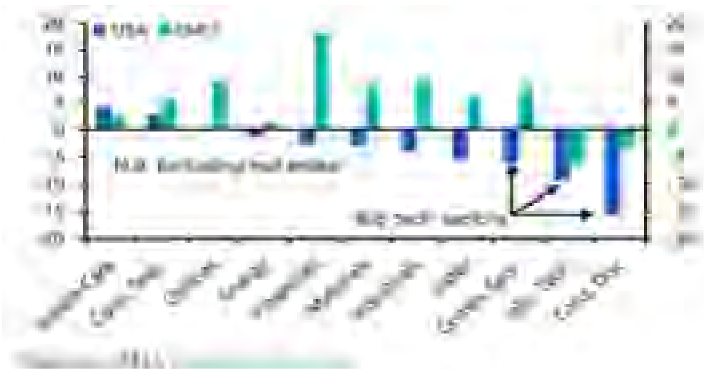
The plan rests on the basis that the majority of the funds raised will be spent in Germany but with manufacturing supply chains radiating across Europe. The magnitude is believed great enough (c.3.2% of

Euro Area GDP) to pull the entire regional economy out of its prolonged torpor. Initially, it is thought likely that a proportion of the equipment purchased could be derived from the United States, a potentially useful means of achieving some negotiating leverage in relation to trade policy. Over time a substitution from made-in-USA to made-in-Europe will take place, providing a handy boost to economic activity.

TRADE

It has almost become a cliché to describe the uncertainty surrounding the Trump administration's trade policies. President Trump decreed 2nd April as US "Liberation Day", referring to the extent to which tariff implementation might level the playing field for US goods manufacturers and exporters. The "Liberation Day" deadline has past and the European Union has been hit with a reciprocal tariff set at 20%. Brussels has indicated that it might retaliate should a negotiated settlement prove elusive. European Central Bank (ECB) President Mme Christine Lagarde has suggested that US tariffs levied on exports from Euro Area might knock 0.3% off GDP this year, but the range of outcomes is wide and depends not just upon how high tariffs might be but how long they could be implemented for. The financial markets' working assumptions were based on a 10% average tariff application on US imports from most of the world, in which case Euro Area GDP might be impacted by around 0.1%-0.2% with the weight falling disproportionately on Germany and Ireland. Until recently this guesstimate was regarded as fairly aggressive, but is clearly too optimistic now, an effective average tariff rate of 20%, potentially knocks as much as 0.5% off regional GDP growth.

The missing link in all the above is the role of the ECB itself. A series of interest rate cuts have taken the region's key deposit rate down to just 2.50%, but the accompanying language from Frankfurt has become progressively less certain regarding the prospect of future policy loosening. Part of the justification lying behind persistent economic weakness lies in the corset imposed by insufficient bank lending. This is nothing new of course, limitations have been in place since the 2007/08 financial crisis, but if Europe is serious about its defence commitments the ECB can play its part by easing lending restrictions. So far, the central bank has yet to acknowledge its role in Europe's transformation but if it does that would surely provide further support to regional stock markets.



THE STOCK MARKET

The prospect of a potential "peace dividend" from an eventual conclusion to the Ukraine war, coupled with looser German (and perhaps over time) regional fiscal policy has galvanised European stock markets. A quick look back confirms that US equity outperformance concluded on Christmas Eve last December since which time longer-term investors have picked up where speculative investors left off. Increased defence spending, improving growth prospects and the likelihood that the ECB will cut interest rates again have proved helpful, as has US "big tech" sector weakness (information technology carries a significantly lower weight in European stock market indices than in the US). Unsurprisingly, the European Industrials sector (including representatives of the aerospace and defence sectors) has proved particularly strong, as has the heavily weighted financials sector (on surging German and regional bond yields). None of this is to say that investor enthusiasm for US equities will not return over time, more that Europe's paradigm shift is forcing investors to reappraise medium and longer-term prospects much more favourably.

KEY TAKEAWAYS

- European stock markets have performed strongly over Q1, outperforming the US in anticipation of fiscal policy loosening and an improvement in economic growth prospects.
- The German Bundestag has voted in favour of constitutional amendments opening the door to sharply higher defence and infrastructure spending, a paradigm shift for the domestic and regional economy.
- Increased defence spending should, over time, offset the near-term adverse growth impact of higher US goods tariffs.
- Subdued inflation has allowed the ECB to cut the key regional interest rate to 2.5% but the pace of future policy loosening is unclear given prevailing geopolitical and trade uncertainties.
- The euro has strengthened on the foreign exchanges, notably against the US dollar and regional government bond yields have risen in large part due to the likelihood of increased issuance and higher (regional) indebtedness.

Is the Golden Rule Overrated? A Case for Industrial Metals

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If you are looking to invest in metals, chances are that gold is what comes to mind first. As headline-grabbing as gold and other precious metals may be, however, they are not the "be all and end all". Industrial metals tend to get less attention, but they offer something precious metals rarely do: performance during a sustained expansion in global demand. In this article, we will delve into the fundamentals of three key metals in the industrial category: steel, copper, and lithium. While the companies focused on mining and processing metals are found in the Basic Resources sector, let's underscore that every sector of the economy depends to varying degrees on a reliable supply of these products.

PRECIOUS VERSUS INDUSTRIAL METALS: WHAT'S THE DIFFERENCE?

The main precious metals—gold, silver, and platinum—are best known for their uses in jewellery, with gold also playing a key role in central bank reserves and private bullion investments. Tiny amounts of precious metals make their way into everyday products, but quantities of industrial metals are far greater. Iron ore and steel stand out for their colossal volumes—billions of metric tons—but even setting those aside, there are many other industrial metals, each with its own set of applications.

The table on the next page shows how prices and volumes of each of the metals have changed over the past five years, versus the pre-COVID baseline. Green shows increases, red shows declines. Prices, of course, always exhibit short-term volatility. Trends in volumes are less visible from day to day. For most metals, the rule of thumb is that global production in any given year is roughly equal to global demand. Here is the distinction between industrial and precious metals: volumes of the former are up almost across the board, whereas for the latter they are flat to down. This point is often underappreciated by investors, who tend to focus on price movements.

STEEL: A PROXY FOR THE CHINESE ECONOMY

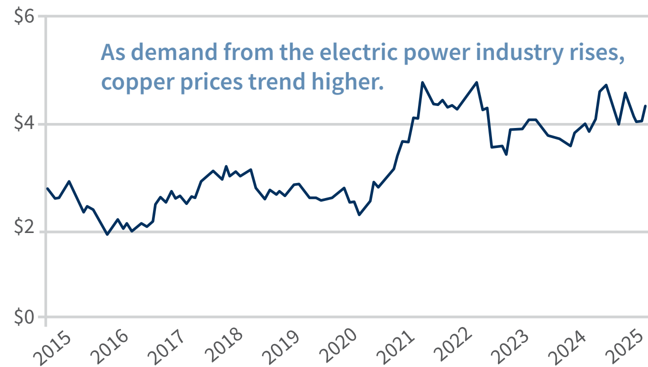
More than a century ago, US Steel became the world's first corporation to reach a billion-dollar capitalisation in stock market terms. Shortly after World War II, what is now the European Union was founded as the European Coal and Steel Community. Nowadays, the steel

Key Statistics Precious and Industrial Metals

		Global Production (thousands of metric tons) 2024 (change from 2019-2024)	Benchmark Pricing	Year End 2024 (change from 2019-2024)	Major Supply Sources
Precious metals	Gold	3 (0%)	$/troy ounce	$2,642 (81%)	China, Australia, Russia
	Platinum	0.2 (-6%)	$/troy ounce	$947 (6%)	South Africa, Russia, Zimbabwe
	Silver	25 (-7%)	$/troy ounce	$30.60 (85%)	Mexico, China, Peru
Industrial Metals (Batteries)	Cobalt	290 (107%)	$/metric ton	$24,300 (-30%)	DR Congo, Indonesia, Russia
	Graphite	1,600 (45%)	$/kg	$2.07 (25%)	China, Madagascar, Mozambique
	Lithium	240 (179%)	CNY/metric ton	¥78,400 (54%)	Australia, Chile, China
	Manganese	20,000 (5%)	CNY/metric ton	¥29.25 (-7%)	South Africa, Gabon, Australia
	Nickel	3,700 (37%)	$/metric ton	$15,758 (17%)	Indonesia, Phillippines, Russia
Industrial Metals (Other)	Aluminum	72,000 (13%)	$/metric ton	$2,607 (48%)	China, India, Russia
	Chromium	47,000 (7%)			South Africa, Kazakhstan, Turkey
	Copper	23,000 (13%)	$/lb	$4.08 (49%)	Chile, Peru, DR Congo
	Iron Ore	2,500,000 (0%)	$/metric ton	$105.32 (19%)	Australia, Brazil, China
	Rare Earths	389 (78%)			China, US, Australia
	Silicon	9,700 (39%)			China, Russia, Brazil
	Steel	1,900,000 (0%)	CNY/metric ton	¥3,340 (-12%)	China, India, Japan

Source: U.S. Geological Survey, Trading Economics, Business Analytiq, Raymond James Equity Research

Source: Trading Economics



Source: Trading Economics, Raymond James Equity Research

ndustry is far down the list of the world's major industries, but it is still the case that steel plays a vital role in everyday life. Half of the world's steel is used in construction: high-rise buildings, bridges, pipelines, and other infrastructure. Most of the other half is used to manufacture machinery, such as vehicles, aircraft, ships, and construction equipment.

The raw material for steel is iron ore, which is mined all over the world, with the top sources being Australia (37% of volumes in 2024), Brazil, China, and India. When it comes to turning iron ore into steel, via a process called smelting, China is the dominant player. In fact, the key benchmark for the steel market reflects Chinese pricing, as shown in the chart. China accounts for half of global steel supply as well as demand, bearing in mind its massive amount of construction and industrial development over the past half-century. More recently, the Chinese economy has slowed, and the hard-hit real estate sector is weighing on construction activity. This is why global steel volumes in 2024 were unchanged from five years ago—after growing during the previous decade— and steel prices are down sharply from their COVID-era highs. For anyone investing in steel or iron ore, the number one factor to keep in mind is the pace of Chinese economic recovery.

COPPER: ESSENTIAL FOR AN ELECTRIFIED WORLD

In volume terms, the copper market equates to only 1% of the steel market, but that understates the importance of copper for the modern economy. The electric power industry as we know it would not exist without large quantities of copper. Half of the world's copper is used to manufacture electrical wire and cable conductors: as a rule of thumb, one metric ton of copper supports the electric grid for thirty homes. Copper is also used in many other types of electrical products, from smartphones to hearing aids. As the economy becomes even more electrified—which includes the buildout of AI data centres and the mainstreaming of electric vehicles—the copper market is poised to sustain healthy growth, following an increase of 13% from 2019 to 2024. In general, we anticipate copper demand growing broadly in line with global GDP.

Copper mining is diversified geographically: Chile is ranked first (23% of volumes in 2024), followed by Peru, the Democratic Republic of Congo, and China. Similar to the point we made about iron ore and steel, copper also needs to be smelted. In this part of the value chain, China is again the dominant player, with other countries having a much smaller presence. However, the copper market is less sensitive to the Chinese economic backdrop, as can

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be seen from the relatively stable copper prices in recent years. Electrification is a worldwide megatrend, and a sizable portion of the copper processed in China ends up in products that are used abroad. All that being said, there is no avoiding some economic cyclicality with copper, given that infrastructure investment and other end markets tend to slow during recessionary conditions.

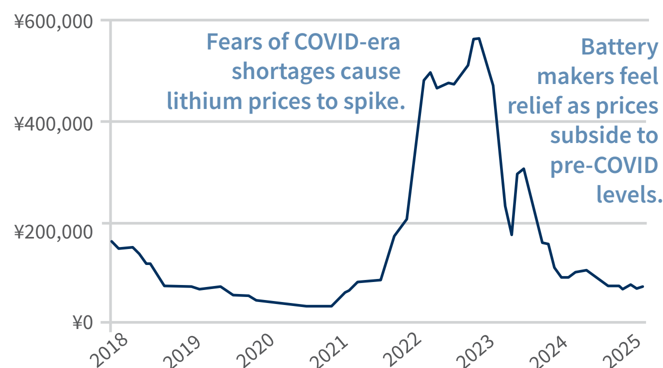
LITHIUM: YOU CAN'T SPELL 'TESLA' WITHOUT 'L'

Lithium stands out for being the world's fastest-growing metal: volumes tripled from 2019 to 2024. Lithium is the most direct play on the boom in lithium-ion batteries. Nearly 90% of lithium goes into the battery market, compared to 30% a decade ago. Interestingly, the largest portion (by weight) of a typical lithium-ion battery is actually not lithium—that distinction belongs to nickel. However, nickel is a much more widely used metal, which means that battery demand is less needle-moving for nickel in relative terms. The other key metals for the battery market are cobalt, graphite, and manganese. The pace of growth in electric vehicle sales can be lumpy from year to year, which translates into commensurate lumpiness in lithium demand, but we generally envision mid-teens annual growth. Lithium prices are more volatile than that which these growth rates might suggest. As shown in the chart, spot pricing in the lithium market experienced a stunning spike during COVID but then posted a similarly steep drop. To clarify, most lithium is sold via multi-year contracts, but the spot market certainly influences how the shares of lithium extraction companies trade on a day-to-day basis.

With 37% of volumes in 2024, Australia is the largest source of raw lithium, followed by Chile, China, and Argentina. Lithium in Australia is mined the traditional way, whereas in South America it is extracted via brines (mineral-rich groundwater that comes to the surface). Growth in the lithium market also explains why there is so much exploratory activity in countries that historically had little to no production, including the US, Canada, and Brazil. Echoing our comments regarding steel and copper, China is the dominant player in lithium refining, handling three-quarters of this work. China also accounts for a similar portion of lithium-ion battery manufacturing, and well over half of the world's electric vehicles are produced in China. China's dominance across this value chain has raised plenty of eyebrows in the US and Europe, numerous governments pushing for reshoring, i.e., shifting production domestically. This will be a marathon rather than a sprint: in the US, there are only two lithium processing plants (one in Nevada, one in North Carolina) currently in operation, with a third (in Oklahoma) in construction.

Chinese Spot Pricing of Lithium Carbonate

(CNY/Metric Ton)



Source: Trading Economics, Raymond James Equity Research

BOTTOM LINE

Along with other commodities, metals can be part of a diversified portfolio. It is important for investors to be aware of both the opportunities and the risks. Prices of precious metals, especially gold, are highly influenced by central bank actions around the world. Industrial metals typically exhibit faster growth in volumes but are tied to developments in the Industrial sector and economic cyclicality more broadly. Furthermore, geopolitical dynamics and operational risks in the mining industry are also worth keeping in mind when considering an investment in the metals sector.

KEY TAKEAWAYS

- Industrial metals—such as steel, copper, and lithium—tend to get less attention than precious metals, but they offer sustained expansion in global demand.
- In China, which accounts for half of global steel supply as well as demand, the hard-hit real estate sector is weighing on construction.
- Copper plays a central role in building out the electric grid, making it vital for the electrification megatrend.
- Lithium, with the fastest volume growth across all metals, represents a play on the battery market.

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