Market Flash

Market reactions following the American customs duties

Written on 10/04/2025

LA FRANÇAISE
Crédit Mutuel Alliance Fédérale

Introduction

François Rimeu
Senior strategist, Crédit Mutuel Asset Management

The American government is not completely immune to what happens in financial markets, and that is perhaps ultimately the most reassuring aspect.

After finally carrying out his threats by imposing highly significant tariffs on the majority of global economies, Donald Trump announced yesterday evening a 90-day truce to allow for negotiations to take place.

However, not all tariffs have been lifted: 10% remain applied to almost all imports from the United States, and the same applies to certain specific measures previously adopted, particularly on automobiles.

The American president had been very explicit about his inflexibility and the persistence of tariffs, but it seems that market turbulence and growing opposition within his own party have led him to show more flexibility. Importantly, China receives specific treatment as not only are the tariffs not suspended, but they have once again been increased and now stand at 125%.

The market rebound is very significant at the time of writing and reflects investors' relief regarding the risk of an impending recession. Yet not everything is resolved, and the impact on the economic cycle will nonetheless not be negligible:

- A 10% increase in tariffs is already significant and will have negative repercussions. Empirically, a 1% increase in tariffs does not translate to a 0.1% increase in inflation and a 0.1% decrease in growth
- Tensions with China remain as intense as ever
- The coming 90 days will likely continue to be marked by contradictory announcements, aggressive rhetoric and, consequently, persistent volatility.

We wrote in our monthly newsletter last Thursday (04/03) that financial markets seemed to us not to be adequately pricing in the risk related to the implementation of tariffs by the United States. We then communicated at the beginning of the week that the risk seemed more symmetrical after the sharp drop in markets.

We maintain this position today. The very significant market rebound reflects a lower probability of recession and confirms that the American government is not completely immune to what happens in financial markets; and that is perhaps ultimately the most reassuring aspect.

It is also useful to remember that, while trade with the United States is obviously important for global growth, it does not seem, in our view, to be of a nature that would plunge the Eurozone into recession. Exports to the United States represent 3.7% of GDP for the Eurozone, which should ultimately generate a greater negative impact on growth for the United States than for the Eurozone in the case of a prolonged tariff war. It is also likely that all countries with fiscal room to maneuver will mobilize these resources to counterbalance the negative effect on growth from American policy: South Korea, Japan, and Great Britain have already made comments to this effect..

Sources: Groupe La Française, Bloomberg. Data as of 09/04/2025

Bonds

Bond markets are reacting with a flight to safety from risky assets and a search for refuge values. Investors now anticipate between 3 and 4 additional rate cuts from central banks on both sides of the Atlantic by the end of the year. Central bankers remain constrained by the inflationary impacts of D. Trump's trade policy, which limits their ability to cut rates. However, the increased probability of a recession in the US economy would likely accelerate monetary easing.

IMPACTS

We initially observed a generalized decrease in rates across bond markets, particularly in the US. Rates then held steady in the United States, which is unusual in this type of market phase and signals growing distrust regarding US trade policy. This was accompanied by a steepening of yield curves, especially in long and very long maturities.

Concurrently, inflation expectations have decreased, with nearly 20 basis points of decline in long-term maturities, as investors appear more concerned about the recessionary effects of the trade war than inflationary effects.

Sovereign debt yields of core countries (particularly Germany) have tended to outperform in this context, with investors favoring quality. The France-Germany 10-year spread widened by 10 basis points, while the Italy-Germany spread widened by approximately 20 basis points. Since the announcement of the 90-day grace period, there has been a partial reversal of these spreads.

On the credit side, we observe both spread widening and risk premium decompression. This means high-beta credit segments have underperformed lower-beta segments. Here too, a partial reversal of spreads occurred after the grace period announcements.

POSITIONING

In our bond management, we had progressively added duration in recent months, allowing us to benefit from the falling rate effect. We have begun reducing duration in recent days while remaining overweight. We believe the potential for rates to fall further is not exhausted at this stage. In terms of geographical allocation, we already had a marked preference for the European core.

We maintain this bias, particularly toward Germany due to its safe-haven status. In credit markets, we had progressively reduced our exposures in recent weeks, both due to a lack of visibility on macroeconomic perspectives and credit risk premiums that seemed relatively expensive to us.

We maintain this prudent positioning for now, especially in the context of reduced liquidity in credit markets, but may opportunistically strengthen certain exposures.

Sources: Groupe La Française, Bloomberg. Data as of 09/04/2025

Past performance is not a guide to future performance.

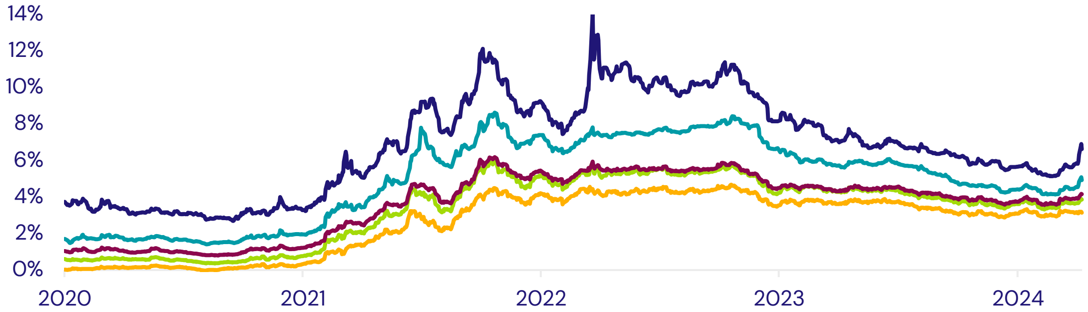
Bonds - Subordinated Debt

In line with the equity markets, subordinated debt had to adjust abruptly to the new geopolitical landscape. While nothing seems certain for more than a few days or hours, the price of uncertainty is partially reflected in asset prices, but more notably in the renewed volatility of high-beta credit markets, both on the upside and downside.

IMPACTS

The price decrease of subordinated debt instruments has followed the classic pattern of volatility shocks in recent years, namely a spread decompression that disadvantages the highest Beta segments (AT1 CoCos and Restricted Tier 1 insurance). Within these instruments, the decline was rather indiscriminate, with however an underperformance of German values (Deutsche Bank, Commerzbank, Allianz), followed by British and Irish banks, according to tariff "headlines."

YTC on subordinated market



Sources: Groupe La Française, Markit, Bloomberg.
Data as of 09/04/2025.

Past performance is not a guide to future performance.

Spreads and yields briefly returned to their mid-2024 levels – after approaching their lowest levels in terms of spreads in February 2025 – and are evolving rapidly in line with equity markets. While flows to credit market segments still seem to be on a favorable trend despite recent uncertainty, we believe that subordinated debt has consequently only reacted belatedly to movements in equity markets, with potentially smaller adjustments in relative value. AT1 CoCos have on average outperformed high-yield European and American debt in terms of spread, which is rare in such market shocks.

POSITIONING

We maintain a defensive position by favouring (I) AT1 CoCos with short calls (2025-2026) that have already been refinanced or with a very high probability of refinancing and (II) subordinated securities with high coupons (more than 6% coupon for AT1€, for example).

We therefore favor the carry component of securities via high coupons, rather than the convexity of lower coupon securities. We do not fear market risk from possible non calls (the recent case of Deutsche Bank's non call AT1 proved, again, that this is not an issue). On Corporate Hybrid, we favour defensive sectors, and we prefer Tier 2 insurance to Restricted Tier 1.

Bonds - High Yield

Like other asset classes, the high-yield bond market has been marked by increased volatility. Risk premiums (spreads) on high-yield bonds has recorded a significant rise over a very short period (3 days), comparable to exceptional market events (such as the COVID-19 crisis in 2020 or the collapse of regional banks in 2023), although the current economic context is different.

IMPACTS

US HY spreads increased by 161 basis points, while European HY spreads increased by 130 basis points. Implicit credit volatility has also reached high levels, particularly in the United States, where it is at its highest in a year. Spreads at 460 basis points for US HY credit are consistent with a low to zero growth regime (between 0% and 1%) and an implicit default rate of 4.5% (taking into account a prudent liquidity premium of 100 basis points and a recovery rate of 30%). The real growth forecast for the United States at the end of 2024 was 3%, and the default rate was 2.5%.

Apart from a recession scenario (which is not our core scenario at the moment), it is difficult to envision a significant increase in default rates. Although spreads may widen further, the risk becomes more asymmetric: the risk of additional spread widening seems more limited than a reverse tightening movement that could bring spreads back to levels between 300 and 350 basis points, in line with moderate growth of 1.5% and an implied default rate of 3 to 3.5%.

POSITIONING

At the beginning of the year, we were cautious on the US HY market, as we felt that valuations were unattractive and that investor positioning was too aggressive. We therefore had a preference for euro credit, due to more attractive valuations.

However, after the recent spread widening in the US market (+160 basis points), we now consider that the US market is becoming more attractive vs beginning of the year. We therefore plan to seize some opportunities with issuers less sensitive to trade tensions and macroeconomic cycles. These include particularly the TMT sectors (technology, media, and telecommunications), healthcare, services to communities, and security, which are more sheltered from fluctuations related to tariffs.

Regarding emerging markets, our position remains unchanged: we remain away from this market. Valuations remain extremely tight, and there is no justification for investing in emerging HY whose spreads are currently lower than those of US high yield bonds, which does not correspond to the historical logic of the markets.

Sources: Groupe La Française, Bloomberg. Data as of 09/04/2025

Past performance is not a guide to future performance.

Expertise Actions

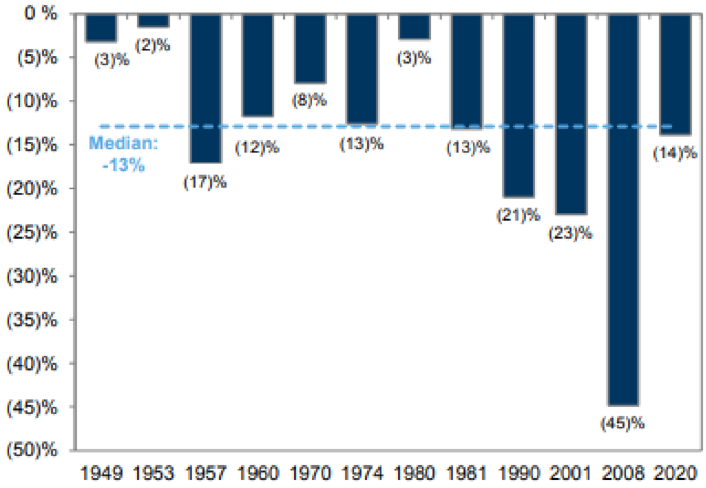
Large Cap

As is often the case, markets initially adopt the worst-case scenario during periods of heightened uncertainty: volatility spikes, sell-off become exaggerated, and the flight to liquidity becomes key. In this context, the S&P 500 experienced one of its sharpest declines since March 2020 (-5.97% on Friday, 04/04), while the Nasdaq entered a bear market. Europe has erased its rise from the beginning of the year, with the Stoxx® 600 dropping 12.43% from its March highs (between 20/03 and 08/04).

IMPACTS

In the U.S., sectors like oil, semiconductors, and discretionary consumption have corrected sharply, while there has been a rebound in the distribution and basic consumption sectors. In Europe, sectoral movements also reflect a rotation towards more defensive sectors, with exits from technology and financials in favor of utilities, telecommunications, and insurance.

Decline in trailing twelve-month earnings per share (EPS) for the S&P 500 during recessions since 1949



ource: Goldman Sachs Global Investment Research

The impacts of Trump's tariff policies are still difficult to quantify, given the complexity of value chains (e.g., the aerospace industry). Strategists are discussing lowered growth expectations, with earnings per share (EPS) for the S&P 500 and Europe expected to stagnate at 0%, though this is not the central scenario today.

The chart on the right illustrates the historical dynamic of S&P 500 earnings per share (EPS) during past recessions. On average, EPS has fallen by around 13% from their previous peak during these downturns.

In Europe, only four sectors — all defensive — have remained in positive territory since the beginning of the year: insurance, banking, telecommunications, and utilities. The Stoxx® 600 is down by -7.68% as of 08/04/2025. Geographically, only the Spanish stock market remains positive (+1.32%) year-to-date, with all other markets having fallen into the red.

Sources: Groupe La Française, Bloomberg. Data as of 09/04/2025

Past performance is not a guide to future performance.

POSITIONING

Quarterly earnings reports will set the tone for new growth outlooks amid the instability generated by D. Trump's announcements.

In this context, portfolios had been partially de-risked (reducing exposure to discretionary consumption and technology stocks) to favor so-called defensive and yield stocks. This approach aimed to maintain a cash position (between 3% and 8%, depending on the portfolio) in order to opportunistically increase certain exposures during periods of market excess.

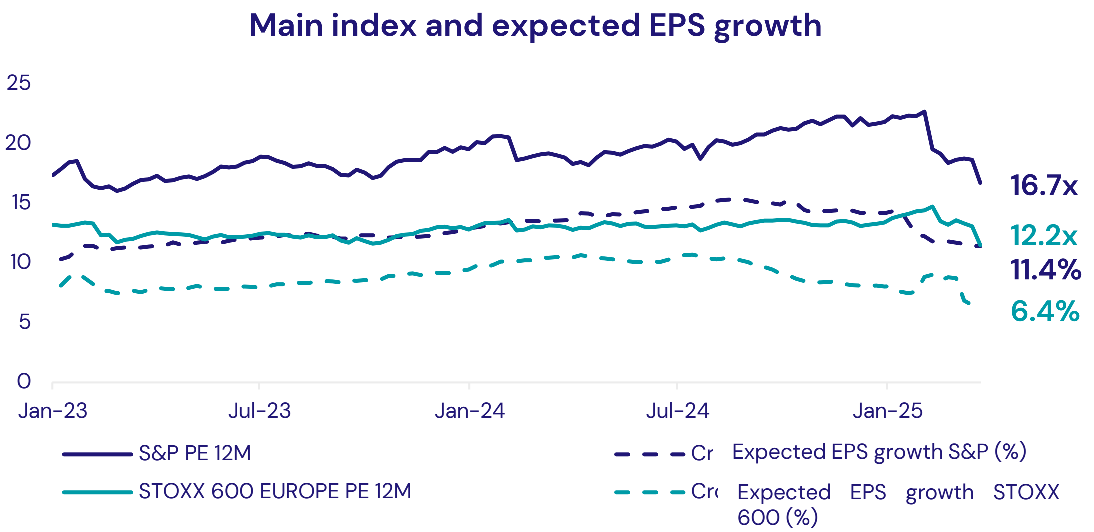
Conclusion

Jean-Louis DELHAY

CIO - Crédit Mutuel Asset Management

Following the announcement of 'Liberation Day' on Thursday, April 3rd, we decided to decrease by one level our equity exposure in our asset allocation to a neutral position slightly underweight.

We thus reduced last Thursday the weight of US equities, destabilized by the decisions of the Trump administration. We also took profits on emerging market equities, whose economies risk being penalized by these new tariff measures. We remained cautious on Japanese equities and maintained a neutral position on European stocks. Last month, we had already reduced risk by cutting exposure to both High Yield and Investment Grade bonds, in favor of government bonds, as the credit spreads on corporate bonds appeared less attractive. In this more uncertain environment, equity market valuation ratios logically decreased significantly, with P/E* for the S&P 500 at 16.7x (2025



Source: Groupe La Française as of 09/04/2025

At this stage, these valuation ratios relative to growth remain stable at 1.5x for the S&P 500 and 2x for the Stoxx® 600 index.

According to recent comments by Christine Lagarde, a 10% increase in US tariffs would have a negative impact of 0.5% on the Eurozone GDP. With 20%, the negative effect would be closer to 1% at least, but GDP stability in the Eurozone this year would not mean recession. In the future, we must take into account potential positive elements such as the massive German investment plan of one trillion euros in infrastructure and defense, and a faster decrease in ECB key rates to support activity.

Given the limited visibility in the short term, we maintain at this stage a globally neutral exposure to equity markets. After the recent decline, valuations may already seem attractive to the extent that recession would be avoided in the United States. A rebound is therefore possible in the medium term if a more favorable compromise on tariffs is finally found between the United States and its main trading partners..

* P/E: Price-to-Earnings Ratio, which represents the ratio between a company's market value and its profits.

**EPS: Earnings Per Share

Published by Groupe La Française, Société Anonyme with a Management Board and a Supervisory Board with a share capital of €78836320 - RCS PARIS 480,871,490.
Crédit Mutuel Asset Management: 128, boulevard Raspail 75006 Paris. asset management company approved by the French financial markets regulator AMF (Autorité des marchés financiers) under number GP 97 138. Public Limited Company (Société Anonyme) with share capital of 3,871,680 euros, registered with the RCS of Paris under number 388 555 021 Code APE 6630Z. Intracommunity VAT: FR 70 3 88 555 021.
Crédit Mutuel Asset Management is a subsidiary of **Groupe La Française**, the asset management holding company of Crédit Mutuel Alliance Fédérale.
La Française Finance Services, an investment firm authorised by the ACPR under number 18673 (www.acpr.banque-france.fr) and registered with ORIAS (www.orias.fr) under number 13007808 on 4 November 2016.
Internet information for the regulatory authorities: Autorité de Contrôle Prudentiel et de Résolution (ACPR) www.acpr.banque-france.fr, Autorité des Marchés Financiers (AMF) www.amf-france.org

LA FRANÇAISE
Crédit Mutuel Alliance Fédérale