

Trump Bluffs—Markets Bite

If the market played poker, it wouldn't last a hand. We all know the drill: create an unreasonable threat, set a worst-case scenario, gain negotiating leverage, backtrack, and declare victory. It's Trump's well-worn playbook—and yet markets keep falling for it. The latest example? His threat of 50% tariffs on European goods from June 1st triggered an anxious market sell-off—only for prices to rebound after a phone call with Ursula von der Leyen led to a delay until July 9th.

Despite the mantra "never trade on politics", markets continue to act in haste. Our focus on mitigating volatility remains valid—but just as important is staying alert to behavioural traps. In times like this, clear communication with clients goes a long way.

An area that warrants more attention, in our view, is the recent decline in long-term bonds. A mix of tariffs, poor fiscal discipline, sticky inflation, and policy risk has led investors to declare a "war on duration"—in simple terms, people are increasingly reluctant to lock in fixed yields for long periods. This tends to happen when excessive government borrowing, and persistent fiscal deficits start to erode investor trust. Last week began with Moody's downgrading the US credit rating, followed by a weak

20-year US Treasury auction on Wednesday—meaning investors demanded higher yields to lend to the US government. In other words: lower bond prices.

Impact: As we've been warning for some time, maintaining exposure to alternative investments (such as gold) continues to make sense as a way to protect capital from a potential inflation spike and further declines in long-dated bonds.

Another important development that could add to US fiscal concerns was the extension of Trump's tax cuts—approved by the House with a razor-thin margin of 215 to 214. While the Senate will likely demand changes, the current version of the bill could add $3.8 trillion to the national debt over the next decade, potentially pushing debt levels to 134% of GDP.

Impact: Ongoing concerns around US fiscal sustainability may continue to weigh on the dollar—affecting both clients' overseas equity exposure and bond valuations. As a reminder, clients' fixed income currency exposure is hedged.

Improved sentiment in May helped the dollar recover but concerns about "de-dollarisation" (i.e. global investors reducing their exposure to US assets) are resurfacing. What's unusual is that this is happening even as the yield gap between US and European bonds widens—investors are being paid more to lend to the US, and yet, that's proving insufficient. Japanese investors, in particular, have been stepping back from US assets, marking a shift after years of ultra-low interest rates in Japan that had previously encouraged overseas bond buying.

Impact: With Japanese bond yields rising sharply, the Bank of Japan may be forced to intervene—raising the prospect of renewed yen volatility.

Another sign of shifting investor preference can be seen in ETF flows. According to Morningstar, European equity ETFs have attracted four times more capital than their US counterparts so far this year. For context, in 2024 the ratio was more than 8-to-1 in favour of the US.

Impact: Global diversification remains essential. US markets have dominated for years, but the tide appears to be turning—at least for now. Although US assets have regained some ground, we remain alert to any opportunistic moves.

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