

Market Shocks, Tariffs & Trends: What Investors Need to Know in 2025

Interviewer (00:06):

Global markets continue to face increasing uncertainty, ranging from geopolitical tensions to the latest tariff developments, and fluctuations in interest rates and inflation. Joining us now to share his insights into how global and regional markets are reacting to these changes and highlight some of the trends emerging in 2025 and beyond is Mark Carver, head of equity analytics and global head of equity solutions at MSCI.

(00:31):

Well, Mark, it's great to have you back with us. Let's start by reflecting on the year so far. How has the market responded to current geopolitical tensions, and global economic events, and how has the backdrop changed since last year? It's very different, to say the least.

Mark Carver (00:48):

Yeah, to say the least, it's very different. Maybe we start there. Where, at this time last year, what we were all talking about was Central Bank policy, and would there be a shift in Central Bank policy to cutting rates? That really buoyed the confidence of equity investors. Obviously, particularly in the US market, we saw a second year in 2024 of very, very sharp market rallies. Obviously, we've talked a lot in this about the concentration, so we don't need to rehash this.

(01:19):

But it's fair to say that this year's quite different. Where investors have a much more uncertain outlook. We're much more concerned, as you said very rightly in the opening, about geopolitical and trade uncertainty, particularly tariffs. That has had a big impact on investors. As we're talking, global investors are facing a market that's down 2%. Excuse me, down 1% if you look at MSCI. For US investors, it's been even more difficult, where MSCI USA is down over 4.5% this year. Developed markets outside the US have done better. We can see that MSCI World ex USA, that's a developed market index, is up 8.2%. Europe has been the darling, Europe's up 13%.

(02:08):

But another contrast to last year is what is driving returns. Where what we're seeing as the darlings of the market this year has been dividend strategies. Maybe investors are trying to go to the perceived safety of those companies that are able to sustain dividends. We're also seeing value strategies do very well this year. For example, if we look at MSCI Europe Enhanced value, that index is up 18%. World ex USA Enhanced Value is up over 13%. Those two indexes are beating their respective parent indexes by 5% and 4% respectively.

(02:49):

Now I'd mentioned, and everybody listening to this call knows, in the US, we've seen a very sharp sell-off over recent days. Negative year-to-date. This is a reflection maybe of two things. One is we came into the year with elevated valuations, and we talked about this in past episodes. But we also have that uncertainty around policy and the potential impact on the economy. Will we have a slowdown, will we

have a recession? That's troubling, because investors entered the year with the notion of US supremacy built on the perception of invincibility with the strength of the AI trade, the innovative make inside of the US. That really boosted both the valuations of companies, but also helped to boost the economic strength of the US. That really was the foundation for the valuation premiums that we saw US markets trade at.

(03:52):

Just to put a point around that, at the end of February, US markets were trading at nearly 22-times forward earnings. That's a 17% premium to the 10-year out. If you contrast that to developed markets outside the US, they're trading at roughly, let's call it 14-times forward earnings. That's roughly in line. Technically, it's 1% premium to the 10-year out, so that's roughly in line. We're seeing very different backdrop to the market versus last year. We're seeing headwinds to the market around policy and geopolitical uncertainty. Obviously, valuations are really forcing investors to rethink the way they're allocating assets.

Interviewer (04:36):

Now, building off of that, what potential effects could the latest tariff developments have on inflation and interest rates? How might they alter market dynamics in 2025 and the years ahead?

Mark Carver (04:49):

Oh, boy. Tariffs paint a very complicated picture for investors, both in the potential impact on inflation, the potential impact on economic growth and do we see a slowdown. The challenge, particularly around pricing assets in the current environment is the uncertainty in the implementation of tariffs, with the will we or not we nature of the way that the tariffs have been forecast I think, at this stage.

(05:21):

Let's first talk about maybe tariffs imposed on imported goods. This will have potentially two effects. One is inflationary, as you hinted at, as companies try to seek, or really try to pass on those higher costs to consumers in the form of higher prices on their goods. The second effect is on the fundamentals of companies themselves. For those companies that try to, let's say, eat the higher costs of the tariffs, that will affect their operating margins and earnings. That will have an effect at the way we think about pricing those particular assets. Surely, they'll probably be a mix of the two effects, where companies pass on portions of the tariff in the form of higher prices on their goods, and then try to obviously consume some of it themselves by maybe reducing margins and operating profits.

(06:14):

As I talk to investors, the overwhelming consensus seems to be more around pushing out those higher prices to consumers, which will be an inflationary effect. That is where people fear that the impact, continued impact of higher prices particularly on the US market could affect consumers' willingness to spend and consume at the same rates. Obviously, any slowdown in the consumer activity could mean a slowdown in economic growth. That obviously has a massive potential impact on assets prices and market valuations. These are the things that we're working on.

(06:54):

There's this other effect of this notion of reciprocal tariffs. A reciprocal tariff, just as people would expect, is this notion that each country will match the tariff rates of another country. Trump

Administration has talked about imposing reciprocal tariffs, starting I think on April 2nd. This could have a few effects. Maybe on the positive side, a reciprocal tariff could impact the US market in a positive way. With the threat of a reciprocal tariff, does that lead other countries to actually reduce the tariff rates on US imports? The result of that could be very good for companies in the US for exporting their goods, as the cost of those goods in foreign markets goes down. That could lead to obviously improved sales. The result of that could be a reduction in the trade deficit. That could be a positive effect from reciprocal tariffs.

(07:54):

That assumes that countries reduce their tariff rates on US goods. It also assumes everything else is equal. That may be a rather big assumption to make. I would note that MSCI has done a fair amount of publication around the impacts of tariffs. My colleagues Thomas Verbraken and Rick Bookstaber actually put out a pretty good piece. I want to get the title right, so I wrote this down. But it's called Scenario Analysis: Tariffs and the Strong Dollar. What they did is they looked at the impact of tariffs on treasury yields, on the dollar, on economic growth and what that could mean for a diversified portfolio by running various scenarios.

(08:42):

I have another colleague, who actually, Jenna, you know, Abhishek Gupta, who wrote a paper back in January, where he used MSCI's economic exposure and geospatial data to look at the industries and countries that could be most effected by US tariffs. Those two pieces I think are a good backdrop for investors to think about the impact of tariffs on their equity program, and obviously on their diversified portfolios. I would point people to both of those pieces.

(09:20):

Now what it means is there's probably three things to watch. What is the effect of tariffs on treasury yields? Obviously, you'd see yields go up as inflation goes up. What is the impact of tariffs on economic growth? Do we see any slowdown in consumer activity? Obviously, what's the impact on the US dollar? Those three things are probably notable for people to watch the way investors are repricing assets based on both the impact and perceived impact of tariffs.

Interviewer (09:53):

Now given tariffs and other market uncertainties, Mark, what approach can investment managers take to manage emotions and improve decision making, particularly during market stress situations like these?

Mark Carver (10:07):

Well, let's be honest. Investors are human. That means that they're subject to emotion. Those emotions can lead to behavioral biases. Behavioral economists talk about this concept of anchoring, which is really we rely too heavily on a single piece of information, sometimes that's our first piece of information. But for investors, today that could be they could overestimate the valuation of their assets, their portfolio based on its peak value. You may anchor that that is the fair value, when in fact it may not be. We also know there are other behavioral biases around this concept of loss aversion, which has led investors to hold onto losers too long because the thought of selling at a loss is just too painful.

(11:03):

Those two things are real and they're present. As I talk to financial advisors and other market participants, they counsel investors to try to simplify the decision making process. Ask yourself some questions like am I properly diversified? Have my goals changed? Are the fundamentals of my portfolio different than they were? Based on that answer, should I be opportunistic in my portfolio rebalancing? By maybe stepping back and asking some of those more simplified foundational questions, investors may take away some of the emotion, ground themselves into why they're allocated the way they are, and then hopefully make informed decisions versus emotional decisions around their portfolio and trading that portfolio.

Interviewer (11:59):

Now let's talk a little bit more about AI, Mark. How are you and your clients leveraging technological advancements and disruptions in sectors like AI? How are investment managers leveraging big data, AI, and machine learning for more informed decision making?

Mark Carver (12:18):

Well, AI, I think I mentioned on a past episode and probably not controversial, AI will change business and society going forward, just like the internet changed business and society 25 years ago. That is maybe the foundational concept behind the AI hype cycle that we've all been living through the last couple of years.

(12:44):

Now what does that mean for investors? Well, what we know today is that investors really are looking for data that gives them an edge, as they like to say. Can they get additional information advantage by looking at new potential data? This could come in the form of news, of research reports, consultant reports, of tweets, of texts. Of auditory datasets, that could be a podcast. It could be other forms of audio information. AI will allow all of that unstructured data to get structured in a way that allows investors to make more informed investment analysis and investment decisions. To be able to find new forms of investment signals, IE in their alpha process, that they can trade in ways that we haven't been able to do.

(13:51):

That's the stuff that our clients are really seeking to get from AI. It's not just trading AI-related names. It's using AI to make more informed investment decisions.

(14:42):

We're optimistic that we can use AI to try to explain more of the risk and return, creating greater transparency for investors. That could be from the way we analyze news and events. That could be in the way that we analyze the weighting of investment descriptors in the capture of a factor, therefore informing and changing the way we ultimately measure risk and return. Investors are really excited about that potential application. Absent AI, we would not have necessarily been able to bring some of that unstructured data into factor model by structuring it, creating investment awareness and signals from it, and then better helping to explain the risk and return of portfolios. As we're talking to clients, they're really eager. Now this is not easy to do. It's going to be a challenge. But this is the opportunity that we see in front of us with the application of AI.

Interviewer (15:46):

You mentioned some of the big things that are coming up in your discussion with clients. How are they thinking about the the year ahead and what's their approach in 2025?

Mark Carver (15:57):

Well, a lot of the things that people were thinking about coming into 2025 had been this notion of US supremacy, as I said earlier. But what that meant, it was this over-allocation to US and US equities in particular. As the year is progressing, here we are mid-March, investors are rethinking their asset allocation. That's not unusual in periods of market transition, which we seem to be going through.

(16:26):

What investors are really thinking about today, as they're telling us, is their asset allocation. Are they diversified across their equity program the way they intended? Do they have the right level of global diversification? And inside that global diversification, do they have allocations to the themes and styles that they think are going to produce the best returns? Very few investors were allocated to global value, for example, coming into the year, despite the fact that value stocks were trading in the US at historic lows and outside the US, not quite as cheap, but still a relative historical basis, quite low. Now we're starting to see investors rethink that type of asset allocation.

(17:18):

Those are things that are common themes we talk about on this program. But they're foundational, they're important. And in periods of transition like we're going through, this is when people start to rethink assumptions and reallocate assets to be both prudent in their risk management and opportunistic in returns that they see potentially going forward as the market shifts.

Interviewer (17:44):

Now we've covered a lot of ground today, Mark. Before we let you go, what could be some of the key takeaways for our audience?

Mark Carver (17:51):

I think some of the key takeaways are that, a question you asked earlier around emotion. Obviously, it's very easy to get caught up in the emotion of the news that's in front of us and the policy uncertainty. The more prudent thing to do is step back and say, "Have my goals changed? Have the fundamentals of my portfolio changed? Can I be opportunistic in my rebalancing?" Which doesn't mean taking on necessarily new exposure. It means am I diversified in the way I want? Am I allocating risk in the way I want? Am I allocating to styles the way I want? Those foundational questions are maybe the things that seem so obvious, but are important particularly in inflection points like we seem to be in now.

Interviewer (18:47):

Well, Mark, we'd better leave it there. Thank you so much for joining us today.

Mark Carver (18:51):

It was great to see you, Jenna. Look forward to talking again.

Interviewer (18:54):

Look forward to it as well. Thank you to everyone out there watching. Once again, that was Mark Carver, head of equity, analytics, and global head of equity solutions at MSCI. I'm Jenna Dagenhart with Asset TV.

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