Our take on tariffs

China update

China's equity markets declined by low to mid-single digits in April, marked by heightened intra-month volatility following the unexpected announcement of new Trump-era tariffs. Beneath these headlines , investors broadly sold off companies with significant overseas revenue exposure, while rotating into domestic consumption and self-sufficiency themes, perceived as beneficiaries of the ongoing US-China decoupling.

- **The MSCI China Index and the MSCI China A Onshore Index fell by -4.55% and -3.51%, respectively.**
- **Sector-wise, technology, media and telecommunications led the outperformance, followed by public utilities, healthcare, and energy.**
- **As market sentiment stabilised and valuations rebounded from mid-to-late April, growth-oriented stocks began to outperform, while low-valuation, value-style names lagged.**

On macroeconomic stability and capital flows

In early April, geopolitical tensions triggered a wave of market panic, leading to a sharp pullback in growth stocks. However, as market sentiment stabilised and valuations rebounded, growth-oriented stocks began to outperform from mid-to-late April, while low-valuation, value-style names lagged. Investors' risk appetite improved notably, with a growing tilt toward sectors and individual names offering higher growth prospects.

Foreign capital flows reflected a mixed picture. There was a net outflow of $12.5 billion under securities investment, yet foreign investors' interest in RMB assets continued to strengthen. By late April, foreign investors had returned to net buying of onshore equities, while net purchases of onshore bonds reached $10.9 billion – remaining at elevated levels.

On the macro front, China's economy demonstrated solid resilience. Industrial production rose by 6.1% in April, and manufacturing investment remained strong. Over the January–April period, total retail sales increased by 4.7%, driven by a robust 7.7% rise in online sales. Fiscal policy support was reinforced through higher budget deficits and expanded bond issuance, fuelling investment in infrastructure and manufacturing. Concurrently, monetary easing measures – including Required Reserve Ratio and interest rate cuts – ensured ample market liquidity.

Trump 2.0 – Uncertainty for the global economy

Since early April, President Trump's unpredictable tariff strategy has triggered significant volatility across global capital markets. The US administration's decision to impose reciprocal tariffs on most major trading partners was far more severe than market participants had anticipated. This led to a substantial correction across stock markets globally. Market sentiment was further whipsawed when a 90-day reprieve was announced for most countries.

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China was the only exception, where the previously announced 145% duties remain in place although at the time of writing .

A key point to note is that the US market and dollar have suffered far greater losses than international markets year-to-date in 2025. One of the primary reasons for this is the significant dispersion of valuations between US and the rest of the world – especially China.

No winners in a trade war – but China is better positioned

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For American consumers, the impact of tariffs on Chinese imports will be particularly severe. Most of these goods are primarily non-substitutable in the near term, making it difficult to find alternatives.

We're already hearing reports that container ships sailing from China to the US are running at half capacity. The US retail sector, including companies like Walmart and Costco, didn't stock up their inventories like the automotive and electronics sectors – and in any event fast-moving inventory for mass retailers will be quickly exhausted. One of our managers explained that about half of Costco's sales are imports from China, and only 10% of these can be quickly substituted by goods from other countries. This dilemma can't be solved overnight, and, in the meantime, we have a COVID-like situation in which American consumers may be unable to buy everyday household items. As it currently stands, the average American family may not have a Christmas tree (at least a plastic one) this year.

By contrast, China's imports from the US are mostly agricultural and energy-related products. US soybeans, for example, are already being substituted with Brazilian ones. Meanwhile, the high-tech products China seeks from the US already face restrictions and are hard to access.

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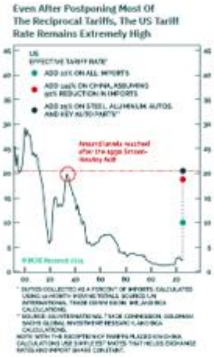
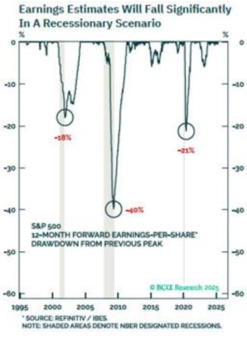
Mounting economic pressures in the US

The US is now grappling with several mounting pressures, including capital market sell-offs, supply chain disruptions, and rising inflation expectations:

- We saw major sell-offs across US bonds, equities, and the dollar following the tariff announcements.
- US companies, particularly small businesses, are highly dependent on global supply chains. Torsten Slok, Chief Economist at the Apollo Group, believes that there is a 90% chance of a tariff-induced US recession, with small businesses – responsible for 85% of capital expenditure and 70% of jobs – likely to suffer the most. These businesses often lack the working capital to absorb a sudden increase in tariffs on imported goods. The effect is widespread, ranging from independent toy stores in Missouri to ski shops in Colorado.
- Higher inflation expectations constrain the Federal Reserve's ability to cut rates.
- Corporate earnings estimates are likely to fall significantly in a recessionary environment.

This damage from inbound tariffs is so substantial that hardly anyone is talking about the impact to US multinationals such as Boeing, which are experiencing higher tariffs on exports to China – which have already led to cancelled orders.





Source: Refinitiv (IBES)

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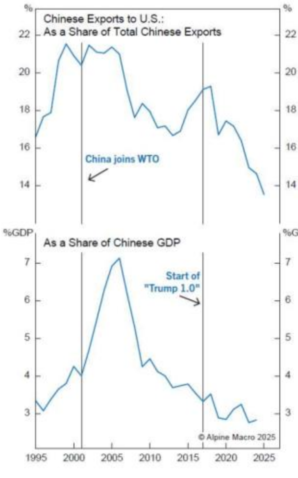
China's strengthened position compared to 2018

On the other hand, China appears far more resilient and prepared than it was during the previous round of tariffs in 2018:

- Beijing's swift and targeted retaliations suggest a well-developed, strategic approach to mitigating economic fallout.
- Chinese exporters have already been reducing their dependence on the US market. The exposure of mainland-listed companies to US revenue is less than 2%, while 90% of revenues of the Chinese Fortune 500 companies are generated domestically.
- Currently, the US accounts for only around 20% of China's total trade (both direct and indirect). Most of this can be replaced by increased trade with the rest of the world and a strong focus on domestic consumption, which is a key policy priority this year. For example, BYD, now the world's leading electric vehicle seller by volume, with 4.27 million vehicles sold in 2024 (more than double Tesla's deliveries), has achieved this without entering the US market.
- China also has a strong policy toolkit, with a loose monetary stance and increased fiscal deficit, now at 4-5% of GDP — the highest in decades.

That said, some damage to the Chinese economy is unavoidable. There are reports of factories shutting down in smaller cities. These smaller companies cannot realistically replace a substantial US buyer (such as Walmart) with domestic customers overnight. Local governments will have to deal with job losses resulting from closures and bankruptcies.



Source: Alpine Macro

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Outlook for US-China trade relations

Looking ahead, we see three potential scenarios for US-China trade relations in the coming months:

1. Prolonged standoff: A continuation of high tariffs that embargos trade between the world's two largest economies – potentially lasting for months or even years.
2. Negotiation and de-escalation: A path towards negotiation and the eventual easing of tensions. While this is the more likely scenario if common sense prevails, it will take time.
3. Further escalation: A deepening of the conflict that could lead to broader financial decoupling – such as pressuring other nations to isolate China, imposing additional sanctions, delisting Chinese ADRs, and more. This escalation could occur before both parties reach the negotiation table.

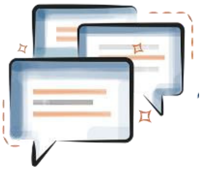
In the near term, it's hard to stop some economic disruption on all sides whether there is a prolonged standoff or an immediate de-escalation. The wheels are already in motion: ships are moving half-empty, factories are being closed, there will be a shortage of supplies, US inflation will rise, and global growth will slow.

The path to stagflation is well underway with reduced confidence, both among consumers and CEOs of companies, and inflation expectations have already spiked.

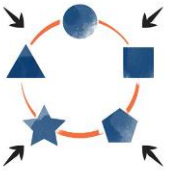
However, further escalation or lack of a reasonable resolution on tariffs will create far greater pain than markets currently are pricing in. How does the world keep going with significantly less trade until all those local factories are built, which will take years?

Approach for an uncertain environment

We are closely monitoring both market conditions and manager behaviour in this environment. Some of the ways they are doing this are:



3 possible scenarios: a prolonged stand-off; negotiation and de-escalation; or further escalation.



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Risk of recession has increased as implied by market pricing of various asset classes.

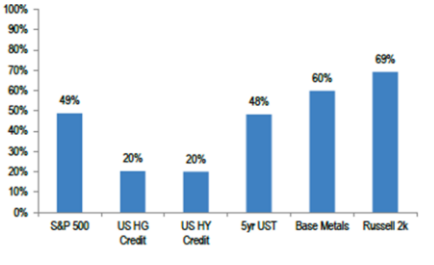
Flexibility will be key; managers need to adjust positioning as new developments emerge.

1. Focus on valuation: Overvalued stocks have further to fall than undervalued stocks.
2. Quality bias: Focus on high-quality stocks, which have demonstrated resilience.
3. Active trading: Using heightened volatility to your advantage by trading opportunistically on valuations and remaining nimble.

There is no sugar-coating the fact that we are entering a period of heightened uncertainty. Market volatility is likely to persist in the near term, with divergent outcomes for different clusters of stocks depending on which scenario unfolds. The risk of a recession has increased as implied by market pricing of various asset classes.

Implied probability of US recession across asset classes as of 22/04/2025

See text for details.



Source: Bloomberg Finance L.P., J.P. Morgan Flows & Liquidity.

Managing money in this environment is exceptionally challenging. Managers need to approach with humility, prepare for worst-case scenarios, and avoid overcommitting to any single outcome. Above all, flexibility will be key as will the readiness to adjust positioning as new developments emerge.

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