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War and Peace

Key Takeaways

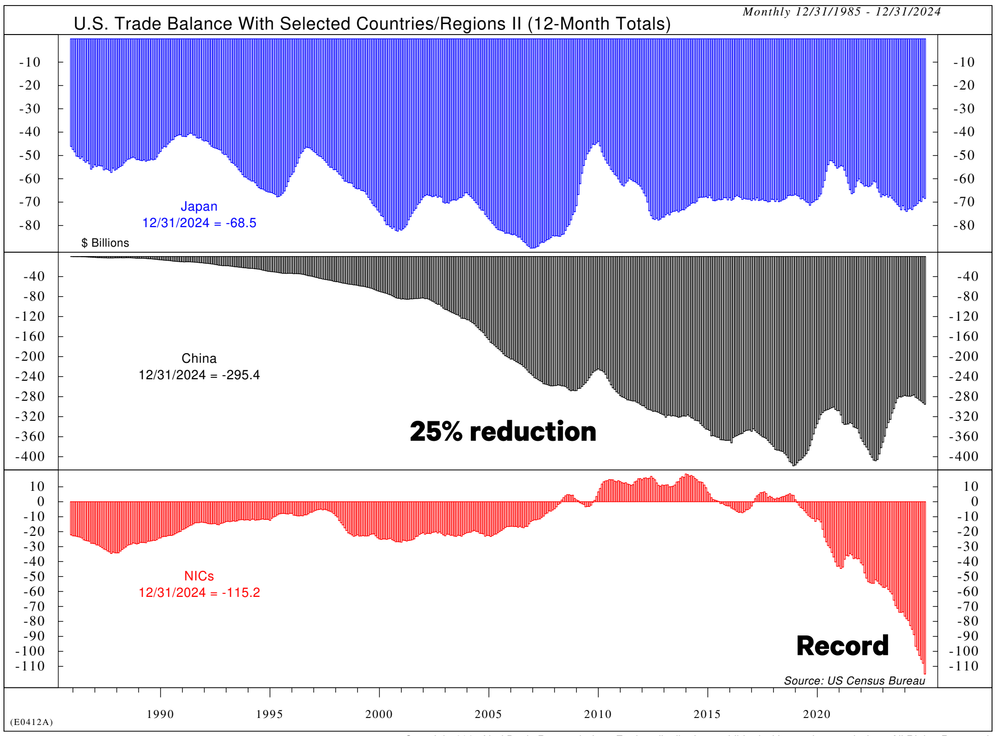
- Trump's tariff threats are being used not only to address trade imbalances but to achieve other policy aims. Europe needs to take responsibility for its own growth.
- A peace deal should benefit Europe by reducing geopolitical risk, increasing the supply of energy, stabilizing prices, and boosting growth.
- Revitalized growth should result in higher yields, a stronger euro, and higher bank and stock prices.

The warnings of war and the prospects for peace have driven the economic and market narratives at least since the November presidential election.

Warnings of war

In his first month as president, Donald Trump resumed his global trade war. But Trump 2.0 is not like the first version. Trump Trade War 1.0 was primarily about trade grievances, especially against China. The U.S. is making progress with China. At the end of 2018, the trade deficit with China was a record $418 billion. By the time Trump left office it was a little over $300 billion. Today it is just under $300 billion, as shown on the chart, so little progress has been made since Trump left office. Team Trump can't be happy about that.

Narrower deficit with China offset by wider deficits elsewhere



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The deficit with China simply went elsewhere. At the end of 2018, our deficit with the NICs (Hong Kong, South Korea, Singapore, and Taiwan) showed a small surplus. Today we have a record deficit of $115 billion. So the $123 billion narrowing with China since 2018 was almost completely offset by a $119 billion widening with the NICs. Team Trump can't be happy about that. They're coming for you.

Trump 2.0, however, is far broader. Although trade imbalances are certainly part of the current version, tariffs are being used to:

- Accomplish other policy goals, including stopping illegal immigration and the flow of fentanyl
- Improve national security
- Provide a source of revenue for paying for additional tax cuts

Additionally, the economic environment is different from what it was back in 2018. The U.S. economy was still recovering from the GFC and inflation was below the Fed's target. Using Trump 1.0 as a roadmap for Trump 2.0 is a mistake in my view. The market's assumption that this is simply a negotiating tactic is too complacent. The risk is that Trump continues to use tariff threats throughout his presidency.

Did Trump do Europe a favor?

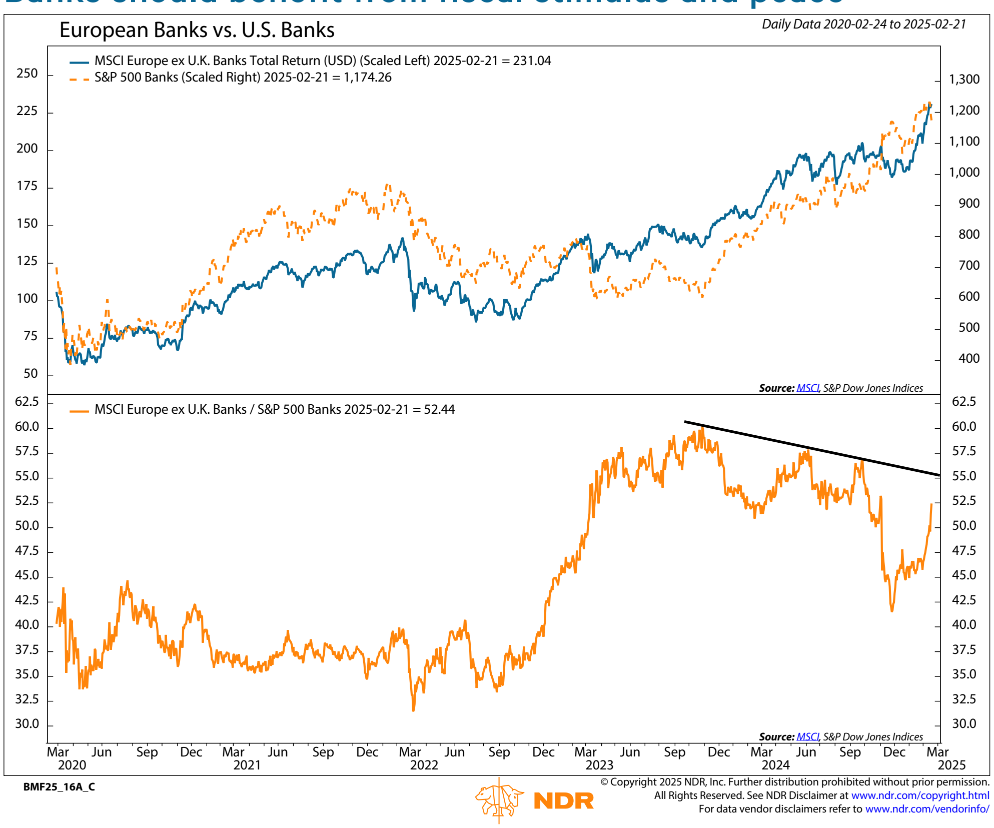
What well-respected Mario Draghi couldn't achieve by himself, Trump may have accomplished for him – giving Europe a swift kick in the butt. In addition to the trade imbalance, Trump is tired of the U.S. being the unpaid policeman of the world. He's tired of other countries benefiting off the largess of the U.S. while we blow out our budget deficit. Trump has effectively announced that **those days are over**. He wants other countries to pay their fair share, threatening to pull out of NATO and other security arrangements if they don't.

That may be just what Europe needs. **Europe needs to take responsibility for its own growth**. It needs to Increase defense spending. It needs to Increase domestic consumption and rely less on exports. That will entail more borrowing for infrastructure, cuts in the bloated bureaucracy, and deregulation.

Prospects for peace

At the same time, Trump is trying to end the three-year old Russia/Ukraine war. Although his methods are unconventional, he just might be able to pull it off, although nothing is assured. A mineral rights deal would strengthen the economic ties between the U.S. and Ukraine and keep the Russians from further aggression at least as long as Trump is president. Europe would benefit from a reduced geopolitical risk premium, increased supply of energy, stable prices, and the reconstruction of Ukraine.

Banks should benefit from fiscal stimulus and peace



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Market implications

The extra borrowing and faster growth should result in higher yields and a stronger euro. We have been overweight European debt since September 2023. Although tentative, outperformance peaked at the turn of the year. We continue to favor peripheral debt, which should also see spreads remain tight if not tighter from faster European growth.

Better growth prospects have propelled stocks higher. **Banks**, which have a bullish composite, **stand to benefit from cheap valuations, increased growth, more lending, and a steeper yield curve is my preferred play**. Mark Phillips, our European Strategist, likes Industrials and makes a case for Energy and Transportation in his latest publication.

We've had false dawns before and this may be another one. Things tend to move slowly in Europe, so maybe it won't happen. Germany just elected a safe choice in Merz, who wants to revitalize the German economy, garnered 28.5% of the vote. Whether he'll be able to do so is another story since he has refused to work with the AfD who took second place with nearly 21%.

But sluggish growth, continued European political turmoil, and Trump's threats may just do the trick. For speculators willing to tolerate or hedge against above-average risks, the rewards might be worth it.

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NDR HOUSE VIEWS (Updated February 13, 2025)

For global asset allocation, NDR recommends an overweight allocation to stocks, marketweight allocation to cash, and an underweight allocation to bonds. Our recommendations are in line with our Global Balanced Account Model.

Equity Allocation

U.S. | Our U.S. asset allocation recommendation is 70% stocks (15% overweight), 25% bonds (10% underweight), and 5% cash (5% underweight). On an absolute basis, we are overweight the S&P 500 (year-end 2025 target of 6600). We are neutral on small-caps versus large-caps (implicit overweight to mid-caps) and neutral on Growth versus Value.

INTERNATIONAL | We are overweight the United States, Canada, and Pacific ex-Japan; underweight Emerging Markets, the U.K., and Japan; and makeweight Europe ex. U.K.

Macro

ECONOMY | The global economy has shown notable resilience, with recession chances waning. Risks include monetary and fiscal policy uncertainty, a potential global trade war, sticky inflation, and easing Chinese growth.

FIXED INCOME | We remain 100% of benchmark duration, and are neutral on the yield curve. We are overweight MBS and underweight CMBS and ABS. We are marketweight everything else.

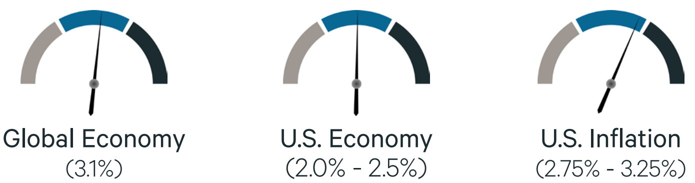
GOLD | We are currently bullish.

CURRENCIES | We are neutral on the U.S. dollar, euro, yen and the U.K. pound.

Economic Summary

February 24, 2025

Near term activity: ● Accelerating ● Neutral ● Decelerating



Economic gauges reflect changes in near-term economic activity. Numbers in parenthesis refer to NDR 2025 forecasts.

Global Asset Allocation

● Overweight ● Marketweight ● Underweight

- ● Stocks (70%)
- ● Cash (10%)
- ● Bonds (20%)

Benchmark: Stocks (55%), Bonds (35%), Cash (10%)

Equities — Regional Relative Allocation

- ● United States 69% | Canada (5%) | Pacific ex. Japan (4%)
- ● Europe ex. U.K. (13%)
- ● Emerging Markets (5%) | U.K. (2%) | Japan (2%)

Benchmark – U.S. (64.0%), Europe ex. U.K. (11.7%), Emerging Markets (10.2%), Japan (5.3%), U.K. (3.4%), Pacific ex. Japan (2.5%), Canada (2.8%)

Global Bond Allocation

- ● Europe (35%)
- ● U.S. (56%) | U.K. (4%)
- ● Japan (5%)

Benchmark: U.S. (57%), Europe (27%), Japan (12%), U.K. (5%)

U.S. Allocation

- ● Stocks (70%) | Mid-Cap
- ● Small-Cap | Large-Cap | Growth | Value
- ● Bonds (25%) | Cash (5%)

Benchmark: Stocks (55%), Bonds (35%), Cash (10%)

Sectors

- ● Financials (16%)
- ● Materials (1%) | Real Estate (1%)

Benchmark: Technology (30.5%), Health Care (11.5%), Financials (12.8%), Communication Services (9.4%), Consumer Discretionary (10.7%), Consumer Staples (6.4%), Industrials (8.5%), Energy (3.5%), Utilities (2.3%), Real Estate (2.2%), Materials (2.2%)

U.S. Bonds — 100% of Benchmark Duration

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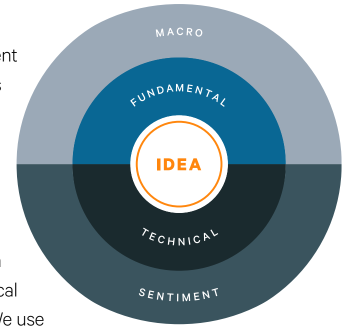

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