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AXA WF US Credit Short Duration IG

Market Update – 7th April 2025

1. Impact of the Latest Tariff Plan on US and Global Economy.

Tariff Rollout & Trade Uncertainty

- The US administration's 'Liberation Day' tariff rollout has led to a **larger-than-expected increase in tariffs**, raising the **weighted average effective US tariff rate to 22.5%** (up **11.5ppt** after recent actions).
- **Trade uncertainty remains high**, with the US showing **no clear signs of reversing policy** and other economies contemplating retaliatory measures.
- If **retaliatory tariffs escalate**, global trade flows may shift significantly, impacting production and exports.
- Despite the hard stance, possibility of **further negotiations remains**, particularly after negative market reaction.

US Economic Impact

- Tariffs could **exacerbate supply shocks**, pushing **core inflation above 3%**.
- Growth outlook revised down to **1.5% for 2025**, with **short-term recession risks rising**.
- **Inflationary nature** of tariff implementation will likely **prevent the Fed** from being able to cut rates to the extent the market currently anticipates. Futures contracts are now pricing in **4 cuts by year-end** starting in June, whereas we think rate cuts will be **back loaded into 2026**, forecasting 4 rate cuts by the end of 2026 to **get us to 3.5%**.

Global Economic Impact

- **Tariffs and trade uncertainty are adding downside risks** to global growth.
- While tariffs **increase costs for certain companies**, the net effect is a **demand shock**, which should **lower global inflation** and give central banks room to ease policy.
- **Retaliatory tariffs could further dampen growth**, while also **raising inflation risks in affected countries**.
- **Uncertainty remains high**, with the US possibly using tariffs as a **bargaining tool** or a **revenue source for future tax cuts**. Some **rollback is possible by year-end**, but overall **tariffs will likely remain higher than initially expected**.

2. US Investment Grade (IG) Market Outlook.

Cautious Sentiment & Trade Tensions

- **Market outlook remains cautious**, driven by **weak sentiment from trade tensions**. Continued preference for **high-quality, liquid names**. **Risk appetite is low**, and volatility remains elevated, with **cyclicals and tariff-exposed names underperforming**.
- Economic growth forecasts may **face downward revisions**, though the impact on **corporate fundamentals will take time to materialize**.

Rates & Valuations

- **Higher probability of Fed easing** is now priced in, reflecting market concerns over growth. But Chair Powell offered some **hawkish leaning commentary** saying the Fed can **wait for more clarity**. **~100bp** of cuts priced in by the market vs. **65bp** a week ago.
- Prior to the tariff announcement, **IG spreads were expected to widen by 10bps this quarter**. Previously at the **lower end of historical ranges**, they have **widened by 20bps last week** and closing on Friday at **114 OAS** (COAO Index). If tariff policy is maintained in the current state, spreads may continue to widen.
- **Rates bull-steepened** (inflation fears), while **equities closed near daily lows**. It was the **worst week** for the S&P500, Nasdaq and Russell 2000 **since Mar-20**. **10Y Treasury** fell around **25bp** during the week, at one point touching **3.90%** for the first time since October.

Market Technicals

- **Supply remains steady**, running slightly ahead of last year's pace, with net issuance expected to decline for the year.
- **Investor flows remain positive**, but upcoming volatility could **test market resilience**. **VIX** finished Friday **above 43** at the highest close **since Apr-20**. **MOVE Index** closed the week **above 125**.
- Liquidity has been impacted with wider bid/ask spreads, particularly in **higher-beta and tariff-sensitive names**.

3. Portfolio Positioning.

Neutral Duration & Risk Positioning

- Target **neutral duration and risk positioning**, with **DTS slightly higher than 100% in the Short Duration IG Fund**.
- **Improving portfolio quality** by reducing **higher beta credits with weaker credit profiles**, anticipating underperformance in a tougher environment.
- **Within sectors**, we are relatively **neutral Financials and Utilities**, while within the broad Industrial sector, we are **overweight Energy, Media, and Telecommunications** and **underweight Technology & Electronics, Retail, Basic Industry, and Autos**.

Conclusion.

- Trade policy remains a key risk, with **tariffs driving uncertainty**, slowing growth, and impacting sentiment across asset classes.
- US IG spreads are widening, driven by **risk-off sentiment** and potential downward revisions to economic growth.
- Liquidity conditions remain challenging, with investors favoring quality and shorter-dated bonds.
- Market volatility is likely to persist, with **Fed rate cut expectations** and global economic developments shaping near-term trends.
- Returns will be influenced by not only spreads but also rates as benchmark treasury rates can move lower in risk off environments supporting total return. Short Duration IG fund still has positive returns MTD.

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