HOUSE VIEW

2025: THE YEAR OF PROUST'S MADELEINE

BancaMarch

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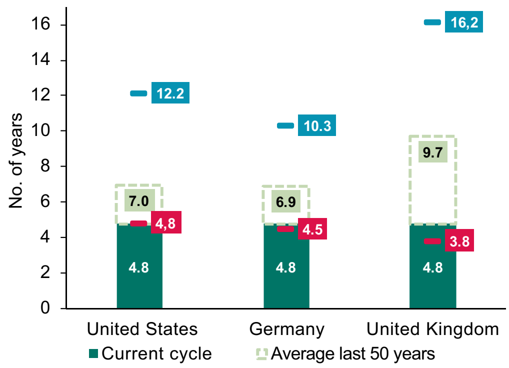
We are moving into a new year with the world in turmoil and with uncertainty rife, although also with the feeling that we have previously faced (and overcome) some fairly similar uncertainties. This kind of Proustian flash gives us the privilege of memory and the prerogative of time, allowing us to look back at the past to retrieve useful information about the future.

As you may recall, Marcel Proust described the flood of memories experienced by his narrator in *Swann's Way* when he ate a madeleine freshly dipped in tea. It triggered a deluge of memories that took his mind back to the past.

This is not Trump's first term in office, nor is it the first time that this particular president has unleashed a torrent of animal spirits —that spontaneous optimism that Keynes said is so influential in business and investment—, and nor for that matter is it the first time that authoritarianism reigns supreme in the White House. What's more, there is nothing new about the global resistance to reducing the swollen public deficits, the doubts over the longevity of the economic cycle, Europe's political inability to turn things around, the Chinese real estate crisis, or the hegemony of the ten largest North American companies, which account for 27% of worldwide capitalisation.

AVERAGE DURATION OF BUSINESS CYCLES

Sources: Bloomberg and Banca March



Without a doubt, the most important thing we should recall from past experiences is that more than 18 months have now passed since US interest rates reached their highest level in a quarter of a century, and yet the cycle is still holding up thanks to strong employment and resilient consumption. A period long enough to confirm our thesis that interest rate hikes do not always end business cycles (historically there has been an average lag of 10 months between the point of maximum monetary tightening and the ensuing recession.

For the time being, not only is there no sign of recession, but the economy is stretching out the cycle that began after COVID-19, almost five years ago, and is still two years younger than average.

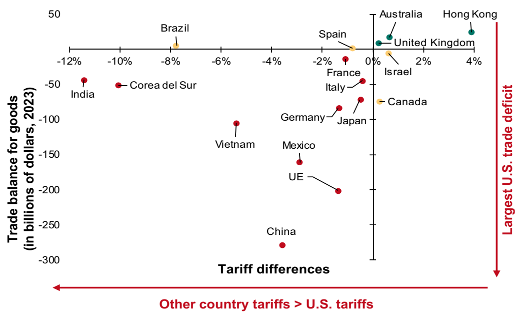
The other madeleine we are beginning to "taste" is Trump 2.0. After a few days of wild declarations and executive orders, it is worth remembering that, during his first term, many of his promises never came to pass. His policy was certainly dominated by "tariff harassment", as well as the biggest deregulation process since Reagan, coupled with an 11% reduction in illegal immigration and further tax cuts.

Yet now, despite his bullishness, he inherits an economy that offers considerably less room for manoeuvre than it did back then: a public deficit of 7% compared to 2.9% in his first term and a public debt to GDP ratio of around 123%, compared to 105% back in 2016. It bears repeating that his tax cuts —very positive for the stock markets— were not accompanied by a reduction in public spending. A good example of this is that, during his first term, he actually increased public employment by 3.4%. Therefore, we are keen to see what Elon Musk will achieve at the helm of the Department of Government Efficiency. The expectations are huge, and yet there is no such thing as magic and the real capacity to act on public spending without the approval of 60% of the Senate is limited to just 2.4% of GDP.

THE UNITED STATES HAS SOME WIGGLE ROOM TO RAISE TARIFFS

Sources: World Bank (WITS), BEA and Banca March

Trade balance with the United States vs. tariff difference(*)



(*) To calculate U.S. tariffs on the EU, the simple average of US tariffs imposed on Germany, France, Italy and Spain is used as a proxy.

The other key point to consider, following this weekend's announcement of further tariffs on Mexico, Canada and China, is to what extent we are facing a widespread trade war, or whether the tariffs are more a bargaining chip and there will be at least a partial reversal. Let us not forget that in 2018, after months of relentless pressure, NAFTA (North American Free Trade Agreement) was ultimately renegotiated between Mexico, the United States and Canada.

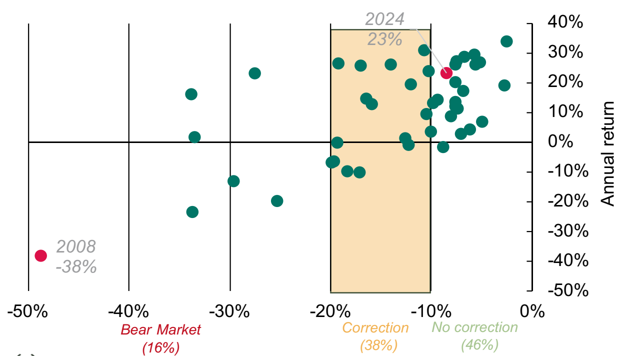
We are inclined to think that, in the end, the tariffs will be more restrained than what was threatened on the campaign trail (which would, by the way, mean the highest tariffs seen in a century), and far from being handed out willy-nilly, they will be targeted at specific countries and sectors, even though some countries might be deserving of them. The diagram above shows how the countries on the lower left not only maintain a trade surplus with the United States, but also charge higher average tariffs than the US imposes on them. For example, the EU charges an average tariff on US products of 5% while the US tariff on the EU is 3.5%, meaning there is a deficit against the US of 1.5%.

Come what may, this situation will give us a few months of complicated diplomatic relations and extreme opposing positions in trade negotiations, combined with drastic plot twists and turns before eventually reaching an agreement. The equity markets will surely be a more volatile place than in 2024, which in our view should be used to continue increasing our exposure to risk. As the chart on the right shows, almost all of the corrections of less than -10% that the S&P 500 has historically experienced are made back during the same year.

CORRECTIONS: CUSTOMARY AND GENERALLY AN OPPORTUNITY

Sources: Bloomberg and Banca March

S&P 500: corrections and annual returns(*)



(*) Since 1980.

The same holds true for 70% of plus 10% losses, provided they take place during the bullish cycle and do not exceed -20%. Moreover, only in five of the 17 years in which there was a correction of between -10% and -20% did the year end in the red.

These flashes from the past show us that no matter how much Make America Great Again takes centre stage, we must remain constructive with risk assets, because at the end of the day, things won't be as bad as they seem and this seventh life of the cycle still has legs.

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