

Monthly Market Update

Markets Love TACO

INFORMATION CONTAINED IN THIS REPORT CURRENT AS AT 16 JUNE 2025

In May, a temporary pause in US-China and US-European tariff escalations, along with a federal court ruling against many Trump tariffs, saw share markets rebound solidly. During the month, Robert Armstrong, a Financial Times journalist wrote an opinion piece on Trump's tariff policies titled "Unhedged". He discussed President Trump's tariff policy and the effects on the US markets. We highlighted last month that this shemuzzle of tariff policy was likely to continue to cause market volatility for quite some time to come. Armstrong said that markets were realising that "the US administration does not have a very high tolerance for market and economic pressure (rightly so) and will be quick to back off when tariffs cause pain". Armstrong called it "the Taco theory - Trump Always Chickens Out".

And with that chickening out in May, markets rallied strongly. The Australian share market increased by 4.2% whilst global shares rebounded 5.9% over the month. It was the strongest monthly return since November 2023 and took both indices close to the levels reached prior to the "Liberation Day" tariff announcements. The US and China announced a 90-day pause in reciprocal tariffs. Although the agreement has since been clouded by accusations of non-compliance by both sides, it significantly reduced perceived risks to global growth. The U.S. Court of International Trade initially ruled the Trump administration's tariffs unlawful - a decision later reversed on appeal.

The EU saw its tariff rate increase to 50% and then fall back to 10%. This vulnerability to trade tensions contributed to both the Federal Reserve's and the ECB's decision to hold interest rates unchanged during the month.

Once again as I was typing, things changed rapidly. Israel bombed Iran causing a spike in the price of oil as markets forecast potential supply disruptions. The implications are that we may see higher inflation (in the short term) as a result. This will likely delay the Federal Reserve to reduce its interest rate and keep bond yields high relative to current inflation readings. Elevated inflation expectations have been keeping the central bank from easing interest rate policy as it tries to avoid these short-term expectations feed into long-term expectations.

Inflation in the US has been moderating however we know that tariffs will raise prices. The consumer price inflation report (CPI) showed an annual inflation rate of 2.4%, which was slightly below expectations. Similarly, the core CPI recorded a yearly rate of 2.8%. Goods inflation was flat, and services inflation held steady at 3.7%. The labour market has held up with the unemployment rate holding at

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4.2% while wage growth was slightly stronger at 3.9% over the year. However, given the weakness seen in the employment components of key business surveys, the risks are increasingly skewed towards cooler jobs growth in the coming months. This will be positive for wage inflation. The Federal Reserve continues to suggest that it expects the Fed funds rate to settle at 3% versus the current 4.5% level. The key question is how long the central bank is prepared to wait until it is comfortable enough to cut? The Fed cannot risk elevated short-term inflation expectations feeding into long-term expectations. As a result, it cannot proactively ease despite weakening growth and labour momentum given tariff negotiations remain unresolved.

In Australia, the economy slowed significantly in the March quarter. GDP increased just 0.2% over the quarter to be 1.3% higher over the year. The expected recovery in private demand continues to underwhelm after consumers experienced the largest decline in purchasing power on record. Consumer weakness has impacted business investment, which rose by only 1.5% over the year, a modest increase compared to historical standards, especially with population growth at 1.7% annually. Public spending remains elevated but should slow in line with a plateauing in infrastructure spending. Highlighting the downside risks to activity, the latest NAB business survey was weak. The business conditions index fell to 0 in May, its lowest level since the pandemic, after a steady three-year downtrend. The result points to continued softness in private demand through mid-year. Housing construction continues to lift as the capacity constraints that have plagued the sector since COVID finally look to be dissipating.

The Reserve Bank lowered the cash rate target by 0.25% to 3.85% at its last meeting, citing increased confidence around inflation and an expectation that international developments would exert some drag on the economy. The Westpac Melbourne Institute Leading Index which indicates the likely pace of economic activity relative to trend three to nine month's time, slowed to 0.2% in April from 0.5% in March. Most of the slowing in the leading index came from sentiment and financial markets rather than a hit to trade and export prices. As such, the RBA is likely to take a cautious, measured approach to policy

easing with the meeting in early July likely to see policy left on hold as it awaits another quarterly update on inflation in late July. Offshore risks were key in the RBA's easing deliberations. The current "roller-coaster" trade war was seen as weighing on both global and domestic growth. One of the key judgements in the RBA's forecasts is that it assessed that the Chinese authorities have a "high appetite" to achieve the 5% growth target for 2025 which may prove a boon for Australia.

That might be optimistic, however after various high-level meetings and a stabilising of the Yuan following the 90-day trade war ceasefire, the Peoples Bank of China cut the benchmark interest rate by 0.10% and the required reserve ratio by 0.50% effectively freeing approximately RMB 1trillion of stimulus. Chinese economic data is moderate and the economy is still experiencing deflation but the easing should set a more positive tone for the future. The sharp escalation of tariffs in April led to a wave of forecast downgrades, as markets weighed the impact on growth. Reports of halted shipping containers and empty ports grabbed headlines. However, China's data releases over the past month, our first real look at the aggregate impact of tariffs, showed a less dramatic slowdown than feared.

The persistent deflationary pressure combined with signs of economic slowdown could combine to allow for the PBOC to ease monetary policy again later in the year. However, the next cut could take some time as the bank may choose to observe economic trends for a few months. If data continues to hold up relatively well, the odds favour a rate cut later in 2025.

The global outlook remains clouded by ongoing tariff negotiations and now the conflict between Israel and Iran. What comes next is hard to predict, but the recent trade deals with China and the UK, along with recent tariff threats against the EU, provide important insights. Overall, the threat of recession remains low with lower interest rates in Australia, China and the US. One exception is Japan where rates are likely to trend higher.

ASSET CLASS RETURNS ARE BASED ON

Australian Cash

RBA Bank accepted Bills 90 Days

Australian Listed Property

S&P/ASX 200 A-REIT TR

International Shares

MSCI World Ex Australia NR AUD

Australian Bonds

Bloomberg AusBond Composite 0+ Yr TR
AUD

International Property Hedged

FTSE EPRA/NAREIT Dv REITS TR Hdg
AUD

Emerging Market Shares

MSCI EM GR AUD

International Bonds Hedged

BarCap Global Aggregate TR Hdg AUD

Australian Shares

S&P/ASX 200 TR

RETURNS TO THE 31ST MAY 2025

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Australian Cash	0.32	0.99	2.04	4.28	3.85	2.34	2.02
Australian Bonds	0.16	2.04	3.71	6.84	3.11	-0.19	2.13
International Bonds Hedged	-0.36	0.14	0.86	5.32	1.42	-0.72	1.83
Australian Listed Property	5.02	6.22	-2.12	12.36	10.59	11.69	7.67
International Property Hedged	2.55	-1.42	-4.45	10.08	0.02	6.28	3.75
Australian Shares	4.20	4.31	1.64	13.36	9.62	12.11	8.12
Emerging Market Shares	3.67	2.72	9.91	16.81	9.02	7.74	5.75
International Shares	5.34	-1.43	3.51	17.60	17.51	14.93	11.94



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