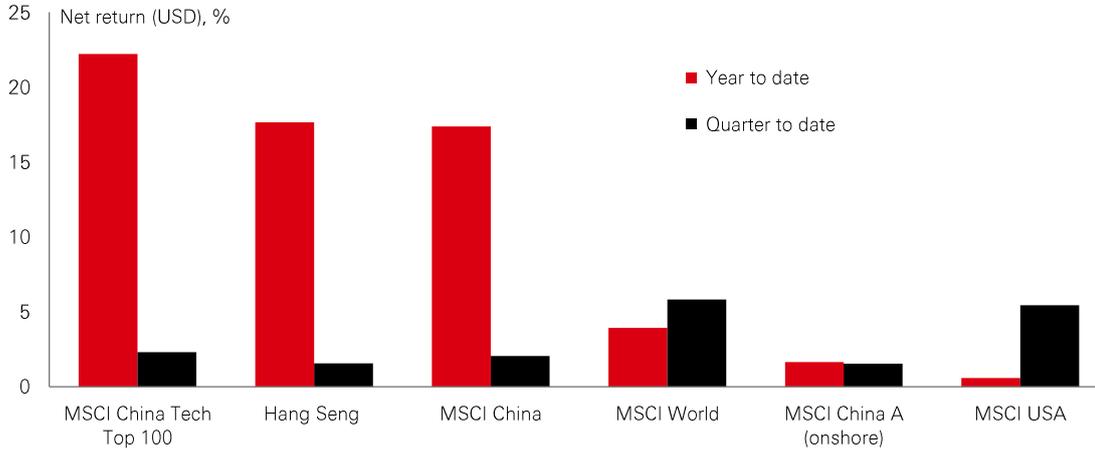


Investment Weekly

19 May 2025

Chart of the week – China’s tech-led rebound



Is it deal-done and crisis-averted in investment markets? Last week’s agreement between the US and China to slash tariffs for at least the next 90 days is the strongest marker yet of a shift to policy de-escalation. In truth, investors have been alert to this theme since the market recovery began in the third week of April. But last week’s price action takes US stocks decisively above their “Liberation Day” levels.

Market price moves naturally reflect **a shift in investors’ assessment of the risks**: lower probabilities now on bad outcomes, and higher probabilities on better outcomes. Even so, it still looks like average US tariffs will settle in the low teens, the highest rate we’ve seen in the post-war period. Macro damage has already been done. And the policy outlook remains ultra-uncertain. An important theme this year has been the **dramatic rotation of the market narrative**. The theme has moved from a universal belief in US exceptionalism in January to a US policy induced recession and worries about economic fragmentation in early April. Now it looks like something in-between. Markets will continue to spin-around.

As for China, the US talks followed a new round of policy stimulus – including rate cuts, targeted easing, credit support, and support for financial markets. Chinese offshore indices have performed well in 2025 driven by strong returns in technology stocks, which continue to be a profit engine, with firms capitalising on DeepSeek-driven AI optimism. By contrast, onshore indices have been weaker, due to lower tech exposures and slightly higher valuations.

Market Spotlight

Euro vision

With the Eurovision Song Contest beaming live from Basel to living rooms around the world last weekend, we bring other news from Europe – but this time on proposed developments in the bond market. Recent questions over the safe-haven status of US Treasuries have been a reminder that investors face limited substitutes given that Europe’s fragmented debt markets fail to offer the depth and liquidity necessary to rival Treasuries. Moreover, structural imbalances between eurozone economies cause destabilising capital flows between “core” and “periphery” nations during stress periods.

The proposal for European Safe Bonds (ESBies) offers a potential solution. In technical-speak, ESBies are the senior tranche of a securitisation vehicle backed by a diversified portfolio of eurozone sovereign bonds, with the junior tranche referred to as European Junior Bonds, or EJBies. They would command enhanced safe-haven premiums through cross-European risk pooling – signalling more market cohesion and serving as a risk-free alternative to German Bunds. They could represent a way of increasing systemic resilience, while addressing the global safe asset shortage and over-reliance on the dollar – **just as US exceptionalism as the sole provider of safety is under scrutiny.**

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Data Outlook →

What ‘hard’ and ‘soft’ data could mean for markets

Frontier Markets →

How Frontier stocks have rebounded from Q2 volatility

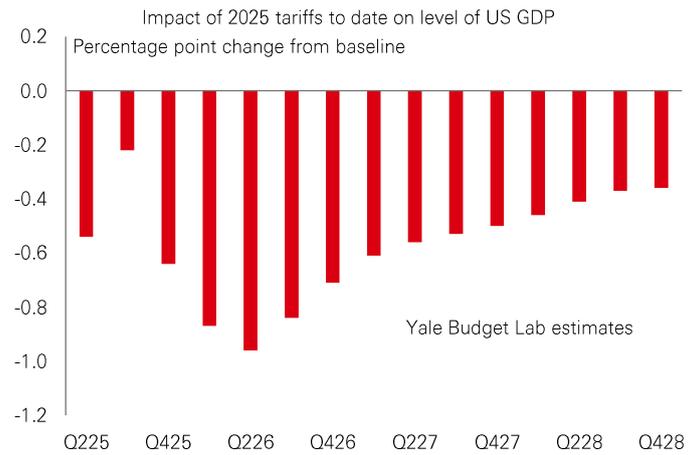
Global Small Caps →

Exploring small-cap valuation discounts

Hard times

The past week saw the US and China agree to substantially reduce tariffs for a 90-day period while working towards a deal. Although clearly positive news, the significant changes in tariff policy since early April are likely to make interpreting macro data tricky in the coming months. The lion's share of survey data – aka "soft data" – for April weakened on the back of "Liberation Day". But May is likely to see some recovery, especially in the context of resurgent US equities.

However, it is worth taking a step back and remembering that even after the thawing of US-China trade relations, the average effective US import tariff has still risen to a post-WWII high. Accordingly, macro models suggest US growth will drop well below trend in the coming quarters. Hence, while "soft" data may stage a recovery, "hard" data are likely to weaken, especially given investment and consumer spending was pulled into Q1 to avoid paying tariffs, likely leaving an "air pocket" in Q2. **In the absence of further positive policy news, weaker "hard" data could trigger some renewed volatility in risk markets.**

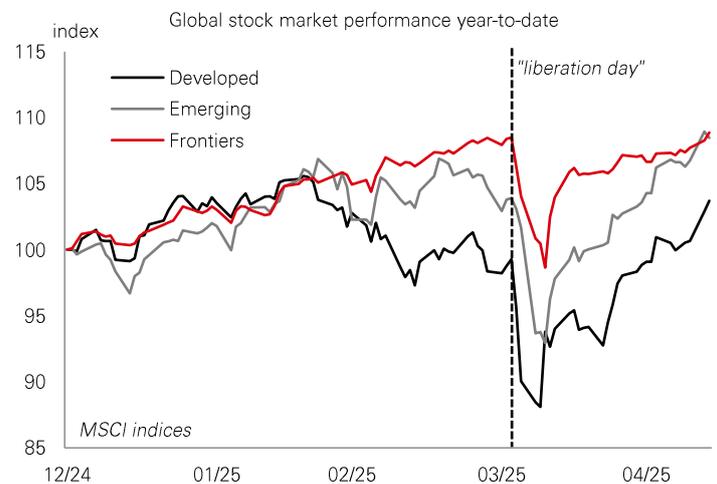


Efficient frontier

When the US government announced plans for reciprocal tariffs in early April, the initial 46% levy on Vietnam (later cut to 10% while trade talks continue) made it one of the worst affected countries. As a fast-growing Frontier manufacturing hub, Vietnam's goods trade surplus with the US has soared in recent years (2024: USD123.5 billion). That's been driven by its popularity with western firms pursuing a "China Plus One" strategy of diversifying their supply chains.

Like other Frontier markets, ultra-high trade policy uncertainty has caused volatility in Vietnamese stocks. But the market has rebounded well, and year-to-date **Frontiers as a group have returned 8.9%, outperforming both developed (3.7%) and emerging (8.5%) markets.**

This positive performance is down to factors including discounted valuations, strong earnings growth, and local country idiosyncrasies that offer protection against macro pressures. In the case of Vietnam, foreign investment is expected to be sticky despite recent uncertainty, with the country's expanding middle class, digital adoption, and urbanisation giving its economy structural resilience.

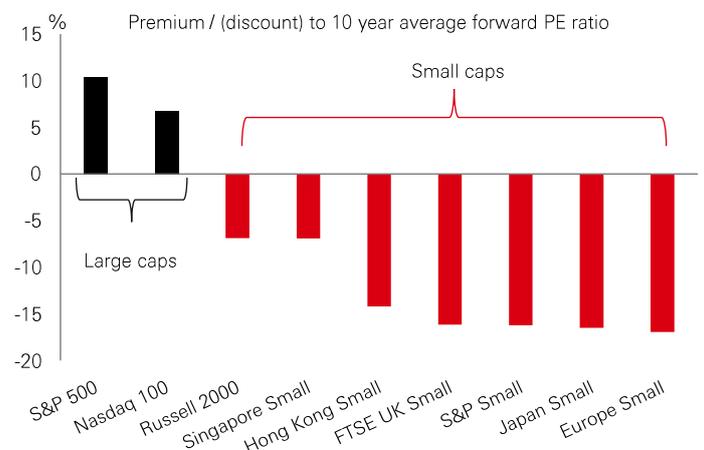


Thinking small

With market rotations continuing, there could be a case for investors to look beyond US large-cap dominance for upside in global small caps.

The US S&P 600 small-cap index has lagged the S&P 500 by over 50% over the past decade. And while investors would be forgiven for losing patience by now, **history suggests smaller firms can deliver big gains after spells out of favour.** Take the 1993-2000 technology bubble. After a serious bout of small-cap neglect, the S&P small-cap index trounced the S&P 500 by 75% from 2001 to 2010.

Small caps have a high beta to both local growth and borrowing. While 65% of US corporate borrowing comes from capital markets, it's only 15-20% in Europe, making those firms more reliant on bank financing. Today, many global small-cap indices trade at a discount of close to 20% versus the last decade. Non-US small caps currently trade below their average 12-month forward PEs, with Hong Kong and UK small-cap PEs close to 10x – half the S&P 500's 20.5x.



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Key Events and Data Releases

Last week

Date	Country	Indicator	Data as of	Actual	Prior
Sat. 10 May	US	Trade agreement with China			
Tue. 13 May	US	NFIB Index of Small Business Optimism	Apr	95.8	97.4
	US	CPI (yoy)	Apr	2.3%	2.4%
	IN	CPI (yoy)	Apr	3.2%	3.3%
Thu. 15 May	US	PPI (mom)	Apr	-0.5%	0.0%
	US	Retail Sales (mom)	Apr	0.1%	1.7%
	JP	GDP (qoq)	Q1	-0.2%	0.6%
	MX	Banxico de Mexico, Overnight Lending Rate	May	8.50%	9.00%
	UK	GDP, Prelim (qoq)	Q1	0.7%	0.1%
	US	Industrial Production (mom)	Apr	0.0%	-0.3%
	EZ	GDP, Flash (qoq)	Q1	0.3%	0.4%
Fri. 16 May	US	Univ. of Michigan Sentiment Index (Prelim)	May	-	52.2

US - United States, IN - India, JP - Japan, MX - Mexico, UK - United Kingdom, EZ - Eurozone

This week

Date	Country	Indicator	Data as of	Survey	Prior
Mon. 19 May	US	Earnings	Q1		
	CN	Industrial Production (yoy)	Apr	5.5%	7.7%
	CN	Retail Sales (yoy)	Apr	5.5%	5.9%
Tue. 20 May	AU	RBA Cash Target Rate	May	3.85%	4.10%
Wed. 21 May	ID	Bank Indonesia Rate	May	5.50%	5.75%
	UK	CPI (yoy)	Apr	-	2.6%
Thu. 22 May	US	Composite PMI, Flash	May	-	50.6
	EZ	Composite PMI, Flash	May	51.2	50.4
	JP	CPI (yoy)	Apr	3.60%	3.6%
	GE	IFO Business Confidence Index	May	87.5	86.9
	UK	Composite PMI, Flash	May	-	48.5
	IN	Composite PMI, Flash	May	-	59.7

US - United States, CN - China, AU - Australia, ID - Indonesia, UK - United Kingdom, EZ - Eurozone, JP - Japan, GE - Germany, IN - India

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Market review

Risk-on market sentiment strengthened last week as the US and China agreed to reduce tariffs to 30% on Chinese imports, and 10% on US imports into China for a 90-day period. US markets now anticipate two rate cuts by year-end, down from nearly three the previous week. The US dollar continued its modest recovery, while US Treasuries declined, alongside similar yield rises in German Bunds and UK Gilts. US and eurozone credit spreads narrowed. US equities surged, driven by technology, with European markets following, supported by strong Q1 earnings in financials and healthcare. Japan's Nikkei 225 posted modest gains as the yen were range-bound. Other Asian indices performed well, led by India's Sensex, followed by Hong Kong's Hang Seng, China's Shanghai composite, and South Korea's Kospi. In commodities, oil prices edged higher, whilst gold retreated from previous week's gains.

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