RATHBONES

TAKE A BREATH

REVIEW OF THE WEEK
17 MARCH 2025

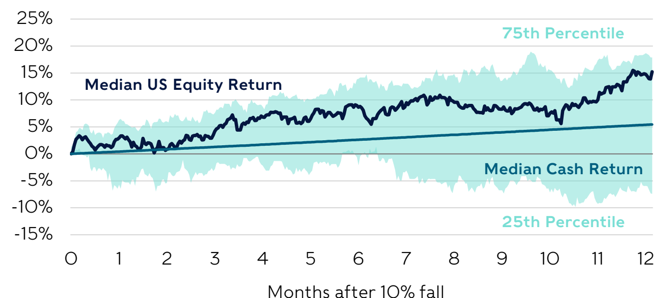
AMERICAN STOCKS HAVE TAKEN A JOLT DOWNWARD, RATTLED BY AN ESCALATING TRADE WAR AND AN UNPREDICTABLE PRESIDENT. IT'S NOT A TIME TO PANIC.

US stocks have had a rough time. In dollar terms, the US S&P 500 index was briefly 10% down from its peak before rallying on Friday.

In the parlance, a 10% drop is known as a 'correction'. While nerve-racking when they're happening, they're relatively common: the S&P 500 has had roughly one a year on average going back to 1930. Usually, markets shrug them off and forge ahead over the following year and beyond. Of course, sometimes instead of bouncing back stocks tank further. When they fall 20% or more, we call that 'a bear market' and it's generally caused by economic recession. Not always, mind, but so often that determining the chance of recession is the most important thing to do when markets wobble.

Some say the recent fall in stocks has been driven by concerns that US economic growth is fading fast, suggesting a recession may be on the horizon. We think an economic contraction is unlikely in the coming year. While American GDP growth has slowed from its recent highs, it's still running at the average of the 2010s, which is a healthy level. The economy would need to do the equivalent of a handbrake turn to start shrinking in the next 12 months.

AVERAGE RETURNS OVER YEAR FOLLOWING 10% FALL IN US STOCKS



Source: LSEG, Rathbones; median returns of all 10% falls since 1 Jan 1980, percentiles show spread of returns

Investments can go down as well as up and you could get back less than you invested. Past performance is not a reliable indicator of future results.

When estimating the chances of a coming recession, we look at a collection of almost 20 series of economic and market data, which have the best track records of predicting economic downturns. These include changes in the money supply, building permits, fluctuations in energy prices, labour market conditions, movements in market interest rates, business surveys and private business investment. Right now, they suggest the chance of recession in the US in the next year is roughly 15%, only fractionally above the long-term average of any given year. However, they aren't fool-proof, and we need to be mindful of the environment and of risks that may not be captured in these numbers.

President Donald Trump's blizzard of executive orders, attempts to cut back government staff and **escalation of a trade war with virtually everyone** has rattled allies, rivals and markets alike. It will take time for the effects to be felt in supply chains and economic data. Applying some qualitative judgement, we think the chance of a US recession is roughly 25%, an assumption that we haven't changed for almost a year **(Trump's policies weren't exactly a secret)**. Trump 2.0 could upend the US economy for sure. But we think it's not the most likely scenario and it would take much longer than markets are suggesting.

With America's trade and foreign policy causing waves, investors could simply be taking profits from companies that have posted some truly extraordinary gains over the past year or two. Since the S&P 500 started selling off in mid-February, the companies that posted the best returns over the past two years have been hit hardest. In contrast, the businesses that had the worst performance have fared well in the past month – in fact, on average they are up by double digits.

It's completely understandable to feel worried when markets start falling, especially when there's so much news and uncertainty flying around. But knee-jerk reactions can be harmful for long-term returns. Often, it's best to take a deep breath.

A mid-year report card for the UK government

We put the chance of a downturn in the UK slightly higher than in the US, at about 30%. The economy is still eking out marginal growth, but households are glum, businesses restive and the government has little room for manoeuvre within its fiscal rules.

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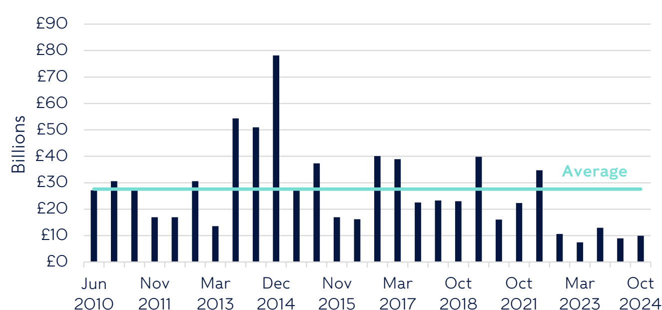
Speaking of fiscal rules, the government's fiscal watchdog, the Office for Budget Responsibility (OBR), is set to give its report card to Parliament on 26 March. It will set out its estimate of current tax receipts and public spending and forecast whether the government is likely to keep to its legally mandated fiscal promises to rein in borrowing and government spending by 2029-30.

Chancellor Rachel Reeves really doesn't want to make any changes to the Budget she set out back in October, but political and fiscal realities may force her hand. Since Labour took power, growth has been sluggish and borrowing costs have increased significantly, squeezing an already-tight fiscal outlook. If the OBR's report shows a big hole in the government's books, it seems politically difficult to shrug it off and say nothing will be done for six months until the next Budget. **We've set out the situation here**, and will be updating you further on the day.

UK'S FISCAL HEADROOM IS RAZOR-THIN VS PAST FORECASTS



As for Europe, we have recently reduced our assumption of the probability of recession substantially from 35% to 25%. That's despite the tariffs currently being imposed by the US. While the deepening transatlantic fissure will hurt European exporters, it has also triggered a serious change in the EU's attitude to loosening the purse strings for public investment and defence spending. We think this could help drag the Continent out of a decades-long slump of low growth. Germany's government-in-waiting appears to have sealed backing for €500 billion in defence and infrastructure spending. This is an economic version of an earthquake: Germany has long been suspicious of borrowing to invest, which is part of the reason why bond yields and central bank interest rates have remained so low on the Continent. This won't be a silver bullet – Europe could do with more business-friendly reforms – it's certainly a great start.

This is a good example of how shocks and policy changes can have more dynamic effects than just 'good' or 'bad'. With so many threats and new policies tumbling out of the White House almost daily, it's creating worry and confusion among people, and markets are just collections of people at the end of the day. But people react and adapt, sometimes predictably, sometimes in ways that we can't foresee.

While upheaval in trade and alliances could hurt many businesses, it's important to note the flipside as well: it can create opportunities for others. It can also mean more investment to do at home what was once done by overseas partners, or a focus on new markets because the old have become uneconomic. We must be humble enough to know that we can't know exactly how these sorts of changes will play out.

Incoming economic data and policy changes could shift the outlook rapidly, but rest assured that we are watching these measures very closely.

*If you have any questions or comments, or if there's anything you would like to see covered here, please get in touch by emailing **review@rathbones.com**. We'd love to hear from you.*

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