Uncommon truths

Tariff pain relief but not the full cure

The US-UK trade deal gives hope that the full pain of the "Liberation Day" tariffs can be avoided. But tariffs are likely to remain higher than at the start of the year, which may be bad news for US stocks.

A lot may have changed since the start of the year, but financial markets only partially reflect that. **Figure 1** shows that in April defensive assets such as government bonds and investment grade credit outperformed more cyclical assets such as commodities and private equity. However, major stock markets and high yield credit hardly suffered. Despite the initial panic after the 2 April 2025 "Liberation Day" announcement, markets appear to have shrugged off those concerns, with many stock markets up a lot in the last month (see **Figure 3**).

Even better, the US-UK trade deal gives hope that the US is now rowing back on some of the most disruptive elements of its reciprocal tariff regime, especially since President Trump also mentioned the possibility of a deal with the EU and reduced tariffs on China if talks go well during the weekend of 10 May 2025.

The main points of the US-UK deal were as follows:

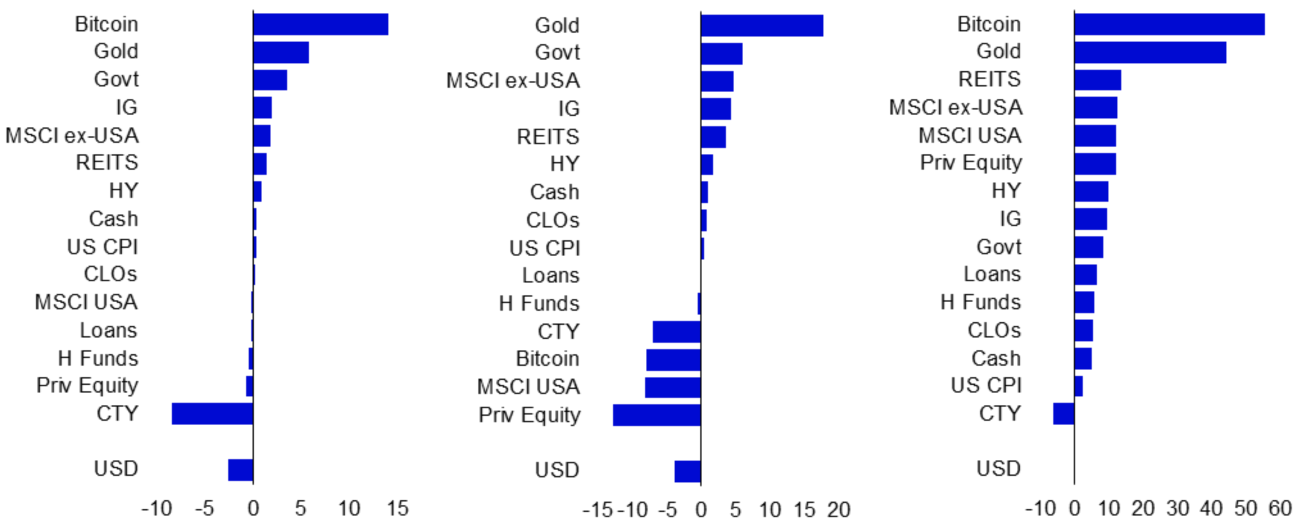
- US tariffs on most UK goods will remain at 10%.
- The US tariff on UK cars will be reduced to 10%, up to a limit of 100,000 cars and 25% thereafter (it had been increased to 27.5% earlier in the year).
- The US tariff on UK steel and aluminium will be reduced to zero (it had been set at 25%).
- The US tariff on engines and plane parts from Rolls Royce will be zero.
- Reciprocal access for beef, with UK farmers given a tariff-free quota of 13,000 tonnes.
- UK tariffs on US ethanol will be reduced to zero.
- The UK will reduce non-tariff barriers to a range of US products including beef, ethanol, machinery and chemicals.

The US-UK deal was far from "full and comprehensive". My calculations (based on UK trade data for 2024) suggest it covers 23% of UK exports to the US (at most) and 35% of US exports to the UK (again on a generous interpretation). The US may have more to gain in the sense that reductions in non-tariff barriers in some areas could boost exports to the UK but, in 2024, goods exports to the UK were only 3.9% of total US goods exports and 0.3% of US GDP (according to US trade data for 2024). On the other hand, UK goods exports to the US were 16% of UK goods exports (or 2.1% of UK GDP).

However, I think the real benefit to financial markets comes not from the details of the deal but rather what it symbolises. It seems to indicate a US willingness to find ways to keep tariffs below those announced on 2 April. In my opinion, the further the US can row back from those reciprocal tariffs, the less will be the damage wrought upon the US economy.

Figure 1 – Global asset total returns over various periods up to 30 April 2025

1 month (% in US dollars) | **3 months (% in US dollars)** | **12 months (% in US dollars)**



Past performance is no guarantee of future results. Based on monthly total return data for global assets in US dollars up to 30 April 2025. Abbreviations are as follows: "CTY" is commodities, "Govt" is government debt", "H Funds" is hedge funds, "HY is high yield credit, "IG" is investment grade credit, "Loans" is bank loans or leveraged loans, "MSCI ex-USA" is MSCI ACWI ex USA Index, "Priv Equity" is private equity, "CLOs" is AAA collateralised loan obligations, "US CPI" is the US Consumer Price Index and "USD" is a trade weighted US dollar index. See appendices for definitions of asset categories and sources.
Source: Bank for International Settlements, ICE BofA, Credit Suisse/UBS, GPR, JP Morgan, MSCI, S&P GSCI, LPX, Bloomberg, LSEG Datastream and Invesco Global Market Strategy Office

Needless to say, all countries that negotiate similar deals with the US will benefit (or suffer less than otherwise) but I think the US will be the biggest beneficiary, as I always believed it had the most to lose. In particular, I think that countries such as Vietnam and Cambodia have a lot to gain, given the importance of trade with the US to their economies (see Who will suffer most from US tariffs?). Though China isn't as exposed to the US, it also has a lot to gain because of the extremely high tariffs imposed upon it (and largely reciprocated by itself).

However, let's not pretend that everything is going back to square one. As the UK deal revealed, 10% may have become the new baseline for tariffs. Though some elements of the UK deal will give hope to other countries (zero tariffs on steel and aluminium and 10% tariffs on cars), it is not clear that all countries will win the same concessions (the UK is not a big player in those sectors); 10% seems the best that can be hoped for. Based on recent comments from President Trump, China may not even be that lucky (ahead of the first talks, he said that 80% felt right for tariffs on China).

Figure 2a shows my own estimates of the maximal first round impact on US CPI and GDP under various scenarios. If the full reciprocal tariffs were imposed, I reckon the consumer price index could receive an initial uplift of up to 3.5% and that GDP would be reduced by around 2.25% (in the first instance). The risk of recession under that scenario is real, in my opinion. As suggested in the chart, the lower the tariffs, the less the economic impact. However, even with a uniform 10% tariff there would still be an effect, with the consumer price index rising by 0.9% and GDP down by 0.6%. I suspect more damage than that is already baked in because of the extreme tariffs now imposed on China and the uncertainty of recent weeks.

Figure 2b shows how stock markets have performed since the start of the year (in US dollars to capture the effect of currency movements). Though the ranking is roughly what I would expect (US suffering more than others; Germany, UK and EU benefitting from the promise of a fiscal boost), I think the decline in US stocks underestimates the potential economic damage, especially if tariffs on China remain at 40% or above.

In conclusion, the US-UK trade deal gives hope that we can move away from the potentially very damaging full reciprocal tariff regime. I wish that my Model Asset Allocation (**Figure 6**) had not been Overweight industrial commodities but at least a relief rally may be starting (see **Figure 3**). The above analysis suggests to me that it is too soon to boost the allocation to US equities, given how expensive I thought they were at the start of the year (I am happy to remain Underweight the US market, in favour of Europe, China and emerging markets). Likewise, I am happy to remain underweight the US dollar.

All data as of 9 May 2025, unless stated otherwise.

Figure 2a – Estimated tariff effect on US economy

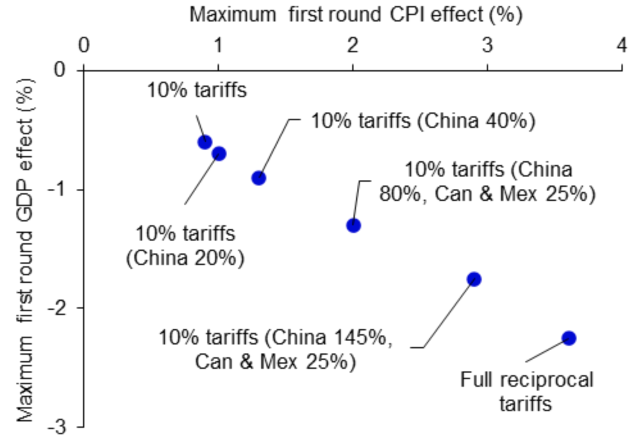
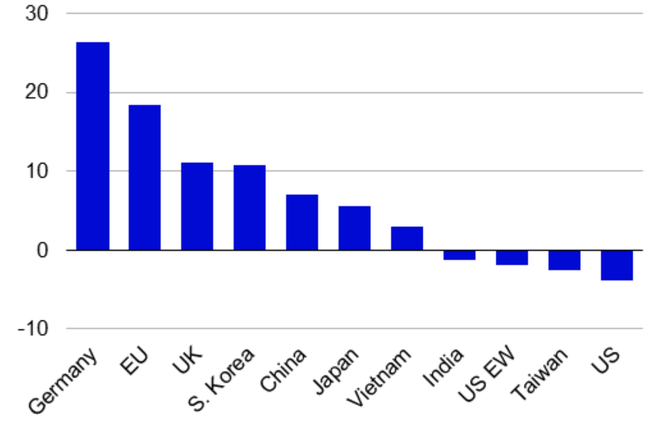


Figure 2b – YTD changes in MSCI indices (US$)



Note: Figure 2a: **There is no guarantee that these views will come to pass**. "Can" is Canada and "Mex" is Mexico. "Maximum first round CPI effect" assumes that 100% of new tariffs are passed on in the form of higher import prices and using the assumption that a rise of 10% in import prices leads to a 1% rise in the US consumer price index (based on research conducted by the US Federal Reserve[1]). "Maximum first round GDP effect" shows our estimate of the immediate effect on US GDP from the squeeze in real incomes and profits that comes from higher import prices, without allowing for multiplier effects etc. "Full reciprocal tariffs" is based on the rates announced on or before 2 April 2025 (including zero for USMCA imports from Mexico and Canada) and the subsequent 145% rate for China. Other scenarios assume 10% tariffs for all countries on all products, with exceptions shown in parenthesis. The exceptions for Canada and Mexico apply only to imports not covered by the USMCA agreement between the US and those countries (in 2024, around 56% of combined imports from Canada and Mexico were not covered by USMCA). Figure 2b: **past performance is no guarantee of future results**. It shows year to date changes in MSCI equity indices in US dollars, as of 9 May 2025. "S. Korea" is South Korea. "US EW" is the MSCI USA Equal Weighted index. "YTD" is year to date. Source: MSCI, LSEG Datastream and Invesco Global Market Strategy Office

References

1. Hottman, Colin J., and Ryan Monarch (2023). "Who's Most Exposed to International Shocks? Estimating Differences in Import Price Sensitivity across U.S. Demographic Groups", International Finance Discussion Papers 1380. Washington: Board of Governors of the Federal Reserve System).

Figure 3 – Asset class total returns (%)

Data as at 9 May 2025	Index	Current Level/RY	Total Return (USD, %) 1w	1m	QTD	YTD	12m	Total Return (Local Currency, %) 1w	1m	QTD	YTD	12m
Equities												
World	MSCI	847	-0.2	8.1	2.7	1.4	10.8	0.0	7.2	1.5	-0.6	9.4
Emerging Markets	MSCI	1138	0.5	14.9	3.7	6.9	10.2	0.3	11.1	1.2	4.0	9.9
China	MSCI	72	0.5	10.9	-1.7	13.1	23.7	0.8	10.9	-1.8	13.0	23.3
US	MSCI	5404	-0.4	4.0	1.2	-3.4	10.2	-0.4	4.0	1.2	-3.4	10.2
Europe	MSCI	2308	-0.4	17.7	6.0	17.3	12.1	0.3	14.7	1.6	8.1	5.8
Europe ex-UK	MSCI	2869	-0.3	18.0	6.9	18.6	12.1	0.5	15.6	2.2	8.7	5.8
UK	MSCI	1352	-0.6	16.4	2.9	12.9	12.3	-0.5	11.6	-0.2	6.2	5.6
Japan	MSCI	4153	0.9	17.0	6.3	6.8	10.1	1.6	17.2	3.1	-1.4	2.6
Government Bonds												
World	BofA-ML	3.28	-0.7	1.0	2.1	5.1	5.6	-0.3	0.1	0.1	0.9	2.8
Emerging Markets	BBloom	6.97	0.2	4.0	0.1	2.9	10.8	0.2	4.0	0.1	2.9	10.8
China	BofA-ML	1.59	0.3	1.8	1.6	1.4	6.5	0.1	0.4	1.5	0.7	6.8
US (10y)	Datastream	4.37	-0.4	-0.1	-0.8	3.2	5.1	-0.4	-0.1	-0.8	3.2	5.1
Europe	Bofa-ML	2.70	-1.0	2.9	5.8	9.1	8.3	-0.1	0.8	1.4	0.2	3.6
Europe ex-UK (EMU, 10y)	Datastream	2.55	-1.1	2.5	6.1	8.1	6.8	-0.2	0.4	1.7	-0.7	2.1
UK (10y)	Datastream	4.56	-0.5	6.6	4.5	8.2	7.9	-0.4	2.2	1.4	1.9	1.4
Japan (10y)	Datastream	1.36	-1.4	-0.7	4.7	6.7	5.2	-0.8	-0.6	1.5	-1.5	-2.0
IG Corporate Bonds												
Global	BofA-ML	4.69	-0.3	2.0	1.1	4.1	6.9	0.0	1.2	-0.2	1.4	5.4
Emerging Markets	BBloom	6.76	0.2	2.6	-1.3	2.7	10.3	0.2	2.6	-1.3	2.7	10.3
China	BofA-ML	2.33	0.3	1.6	1.0	1.5	4.5	0.1	0.2	1.0	0.7	4.8
US	BofA-ML	5.35	0.0	1.1	-0.8	1.6	5.3	0.0	1.1	-0.8	1.6	5.3
Europe	BofA-ML	3.22	-0.8	3.3	5.2	9.9	10.4	0.1	1.2	0.8	1.0	5.5
UK	BofA-ML	5.55	-0.4	6.7	4.1	7.8	10.3	-0.3	2.3	1.0	1.5	3.7
Japan	BofA-ML	1.35	-0.9	-0.5	3.9	8.2	7.0	-0.2	-0.3	0.7	-0.2	-0.3
HY Corporate Bonds												
Global	BofA-ML	7.68	0.1	3.4	1.2	3.2	9.2	0.3	2.9	0.3	1.5	8.2
US	BofA-ML	7.94	0.2	3.0	0.6	1.5	8.2	0.2	3.0	0.6	1.5	8.2
Europe	BofA-ML	6.04	-0.4	5.1	5.1	10.3	12.7	0.5	3.0	0.7	1.4	7.8
Cash (Overnight rates)												
US		4.29	0.1	0.4	0.5	1.6	4.9	0.1	0.4	0.5	1.6	4.9
Euro Area		2.17	-0.4	2.9	4.2	9.6	7.7	0.0	0.2	0.3	0.9	3.2
UK		4.21	0.3	4.2	3.5	8.1	11.5	0.1	0.4	0.5	1.6	4.9
Japan		0.48	-0.3	1.7	3.2	8.3	7.2	0.0	0.0	0.1	0.2	0.3
Real Estate (REITs)												
Global	FTSE	1638	-0.4	9.3	2.4	4.1	9.4	0.5	7.0	-1.9	-4.4	4.7
Emerging Markets	FTSE	1195	-1.6	10.8	3.7	2.9	2.3	-0.7	8.6	-0.6	-5.4	-2.2
US	FTSE	3130	-0.5	5.7	-1.5	-0.5	11.5	-0.5	5.7	-1.5	-0.5	11.5
Europe ex-UK	FTSE	2629	-0.6	19.6	13.0	15.8	12.6	0.3	17.1	8.3	6.4	7.7
UK	FTSE	883	-1.1	20.1	8.4	13.9	1.3	-0.9	15.1	5.1	7.2	-4.7
Japan	FTSE	2280	-1.0	7.6	7.2	19.6	6.8	-0.3	7.7	4.0	10.3	-0.4
Commodities												
All	GSCI	3605	2.2	2.3	-6.0	-1.4	-2.3	-	-	-	-	-
Energy	GSCI	586	4.3	-0.2	-12.1	-7.9	-10.3	-	-	-	-	-
Industrial Metals	GSCI	1679	0.7	8.1	-3.1	2.0	-6.0	-	-	-	-	-
Precious Metals	GSCI	3650	3.1	8.9	5.7	24.9	39.0	-	-	-	-	-
Agricultural Goods	GSCI	506	-1.5	-0.6	-0.6	-1.8	-3.1	-	-	-	-	-
Currencies (vs USD)*												
EUR		1.12	-0.4	2.7	4.0	8.6	4.3	-	-	-	-	-
JPY		145.36	-0.3	1.6	3.2	8.1	6.9	-	-	-	-	-
GBP		1.33	-0.1	4.3	3.1	6.2	6.3	-	-	-	-	-
CHF		1.20	-0.6	3.2	6.4	9.1	9.0	-	-	-	-	-
CNY		7.24	0.5	1.6	0.3	0.9	-0.2	-	-	-	-	-

Notes: **Past performance is no guarantee of future results.** *The currency section is organised so that in all cases the numbers show the movement in the mentioned currency versus USD (+ve indicates appreciation, -ve indicates depreciation). Please see appendix for definitions, methodology and disclaimers.
Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 4 – Global equity sector total returns relative to market (%)

Data as of 09 May 2025	Global				
	1w	1m	QTD	YTD	12m
Energy	**0.5**	**-3.5**	**-8.5**	**-3.8**	**-15.2**
Basic Materials	**0.4**	**3.0**	**-0.4**	**5.5**	**-12.3**
Basic Resources	1.1	4.8	0.0	8.0	-11.1
Chemicals	-0.6	0.5	-1.0	1.8	-14.0
Industrials	**1.0**	**2.8**	**2.2**	**3.7**	**0.2**
Construction & Materials	0.3	4.8	6.1	7.4	1.0
Industrial Goods & Services	1.1	2.5	1.6	3.2	0.1
Consumer Discretionary	**0.7**	**0.7**	**2.6**	**-2.3**	**1.3**
Automobiles & Parts	2.1	4.1	6.7	-11.7	1.7
Media	2.5	7.5	9.4	10.6	19.5
Retailers	0.4	-2.6	0.9	-2.8	4.3
Travel & Leisure	0.5	-1.2	0.4	-3.9	-0.5
Consumer Products & Services	-0.5	2.6	1.6	3.1	-8.1
Consumer Staples	**-0.5**	**-2.6**	**-0.1**	**8.5**	**-1.7**
Food, Beverage & Tobacco	-0.4	-2.4	0.0	9.5	-2.7
Personal Care, Drug & Grocery Stores	-0.6	-2.8	-0.2	6.8	0.1
Healthcare	**-4.0**	**-6.0**	**-7.6**	**-3.5**	**-12.6**
Financials	**0.5**	**2.5**	**-0.2**	**7.2**	**11.4**
Banks	0.8	4.8	0.2	8.8	12.8
Financial Services	0.0	0.2	-0.2	3.1	8.2
Insurance	0.3	1.1	-1.0	11.0	13.9
Real Estate	**-0.4**	**0.8**	**0.0**	**3.4**	**1.0**
Technology	**0.1**	**-0.5**	**2.6**	**-7.9**	**1.9**
Telecommunications	**0.4**	**-0.4**	**-0.2**	**9.2**	**11.9**
Utilities	**-0.2**	**-0.3**	**0.6**	**6.1**	**1.0**

Notes: **Past performance is no guarantee of future results.** Returns shown are for Datastream sector indices versus the total market index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 5a – US factor index total returns (%)

Data as at 9 May 2025	Absolute					Relative to Market				
	1w	1m	QTD	YTD	12m	1w	1m	QTD	YTD	12m
Growth	0.4	5.9	3.7	-2.4	1.9	0.8	2.0	2.7	1.0	-7.3
Low volatility	-0.8	2.4	-2.6	2.6	10.9	-0.4	-1.3	-3.5	6.2	0.8
Price momentum	0.1	5.7	1.8	-1.5	9.5	0.6	1.8	0.9	1.9	-0.4
Quality	0.9	5.2	0.3	0.2	1.9	1.4	1.3	-0.6	3.7	-7.4
Size	1.0	3.9	-1.6	-3.0	1.5	1.4	0.1	-2.6	0.3	-7.8
Value	0.5	4.6	-1.9	1.1	8.6	0.9	0.8	-2.8	4.5	-1.3
Market	-0.4	3.8	1.0	-3.3	10.0					
Market - Equal-Weighted	0.4	4.5	-0.4	-1.0	6.0					

Notes: **Past performance is no guarantee of future results.** All indices are subsets of the S&P 500 index, they are rebalanced monthly, use data in US dollars and are equal-weighted. Growth includes stocks in the top third based on both their 5-year sales per share trend and their internal growth rate (the product of the 5-year average return on equity and the retention ratio); Low volatility includes stocks in the bottom quintile based on the standard deviation of their daily returns in the previous three months; Price momentum includes stocks in the top quintile based on their performance in the previous 12 months; Quality includes stocks in the top third based on both their return on invested capital and their EBIT to EV ratio (earnings before interest and taxes to enterprise value); Size includes stocks in the bottom quintile based on their market value in US dollars. Value includes stocks in the bottom quintile based on their price to book value ratios. The market represents the S&P 500 index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 5b – European factor index total returns (%)

Data as at 9 May 2025	Absolute					Relative to Market				
	1w	1m	QTD	YTD	12m	1w	1m	QTD	YTD	12m
Growth	1.5	17.0	4.1	4.5	4.6	0.9	1.2	2.2	-3.1	-2.8
Low volatility	0.6	13.7	4.0	13.1	17.1	0.0	-1.6	2.2	4.9	8.9
Price momentum	1.2	19.5	6.3	15.5	21.5	0.6	3.4	4.4	7.1	13.0
Quality	0.7	16.8	4.1	8.3	7.3	0.1	1.0	2.3	0.5	-0.2
Size	1.0	17.2	4.4	5.2	4.0	0.4	1.4	2.5	-2.5	-3.3
Value	1.6	20.2	5.4	13.8	14.0	1.0	4.0	3.5	5.5	6.0
Market	0.6	15.6	1.8	7.8	7.5					
Market - Equal-Weighted	1.0	16.9	3.9	8.1	9.1					

Notes: **Past performance is no guarantee of future results.** All indices are subsets of the STOXX 600 index, they are rebalanced monthly, use data in euros and are equal-weighted. Growth includes stocks in the top third based on both their 5-year sales per share trend and their internal growth rate (the product of the 5-year average return on equity and the retention ratio); Low volatility includes stocks in the bottom quintile based on the standard deviation of their daily returns in the previous three months; Price momentum includes stocks in the top quintile based on their performance in the previous 12 months; Quality includes stocks in the top third based on both their return on invested capital and their EBIT to EV ratio (earnings before interest and taxes to enterprise value); Size includes stocks in the bottom quintile based on their market value in euros; Value includes stocks in the bottom quintile based on their price to book value ratios. The market represents the STOXX 600 index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 6 – Model asset allocation

	Neutral	Policy Range		Allocation	Position vs Neutral	Hedged Currency
Cash Equivalents	**5%**	**0-10%**		**0%**		
Cash	2.5%			0%		
Gold	2.5%			0%		
Bonds	**40%**	**10-70%**	↓	**35%**		
Government	25%	10-40%	↓	21%		
US	8%		↓	6%		50% JPY
Europe ex-UK (Eurozone)	7%			7%		
UK	1%			2%		
Japan	7%		↑	2%		
Emerging Markets	2%			4%		
China**	0.2%			0%		
Corporate IG	10%	0-20%	↓	10%		
US Dollar	5%		↓	5%		50% JPY
Euro	2%		↓	1%		
Sterling	1%			2%		
Japanese Yen	1%			0%		
Emerging Markets	1%			2%		
China**	0.1%			0%		
Corporate HY	5%	0-10%		4%		
US Dollar	4%			3%		50% JPY
Euro	1%			1%		
Bank Loans	**4%**	**0-8%**		**8%**		
US	3%			6%		
Europe	1%			2%		
Equities	**45%**	**25-65%**	↑	**45%**		
US	25%		↑	12%		
Europe ex-UK	7%		↑	12%		
UK	4%		↑	6%		
Japan	4%		↑	5%		
Emerging Markets	5%		↑	10%		
China**	2%			4%		
Real Estate	**4%**	**0-8%**	↑	**8%**		
US	1%		↑	1%		
Europe ex-UK	1%			2%		
UK	1%			2%		
Japan	1%			2%		
Emerging Markets	1%		↑	1%		
Commodities	**2%**	**0-4%**		**4%**		
Energy	1%		↑	2%		
Industrial Metals	0.3%		↓	1%		
Precious Metals	0.3%			0%		
Agriculture	0.3%			1%		
Total	**100%**			**100%**		
Currency Exposure (including effect of hedging)						
USD	52%		↓	30%		
EUR	19%		↓	25%		
GBP	7%			12%		
JPY	13%		↑	16%		
EM	9%		↑	17%		
Total	**100%**			**100%**		

Notes: **China is included in Emerging Markets allocations. This is a theoretical portfolio and is for illustrative purposes only. See the latest The Big Picture document for more details. It does not represent an actual portfolio and is not a recommendation of any investment or trading strategy. Arrows indicate the direction of the most recent changes.
Source: Invesco Global Market Strategy Office

Figure 7 – Model allocations for global sectors

	Neutral	Invesco	Preferred Region
Energy	**6.3%**	**Overweight**	**EM**
Basic Materials	**3.4%**	**Neutral**	**Japan**
Basic Resources	2.0%	Neutral	Japan
Chemicals	1.3%	Overweight ↑	US
Industrials	**13.1%**	**Underweight**	**US**
Construction & Materials	1.7%	Underweight	US
Industrial Goods & Services	11.4%	Underweight ↓	US
Consumer Discretionary	**14.2%**	**Underweight**	**US**
Automobiles & Parts	2.3%	Underweight	Europe
Media	1.2%	Overweight	US
Retailers	5.5%	Overweight	US
Travel & Leisure	1.9%	Underweight	EM
Consumer Products & Services	3.2%	Underweight	Japan
Consumer Staples	**5.3%**	**Neutral**	**US**
Food, Beverage & Tobacco	3.4%	Neutral ↓	US
Personal Care, Drug & Grocery Stores	2.0%	Overweight ↑	Europe
Healthcare	**8.8%**	**Underweight**	**US**
Financials	**17.2%**	**Overweight**	**US**
Banks	8.2%	Overweight	US
Financial Services	5.6%	Underweight ↓	US
Insurance	3.3%	Neutral	US
Real Estate	**2.7%**	**Overweight ↑**	**Japan**
Technology	**22.0%**	**Neutral**	**EM**
Telecommunications	**3.6%**	**Neutral ↑**	**US**
Utilities	**3.4%**	**Overweight ↑**	**US**

Notes: These are theoretical allocations which are for illustrative purposes only. They do not represent an actual portfolio and are not a recommendation of any investment or trading strategy. See the latest Strategic Sector Selector for more details.
Source: LSEG Datastream and Invesco Global Market Strategy Office

Appendix

Methodology for asset allocation, expected returns and optimal portfolios

Which asset classes?

We look for investibility, size and liquidity. We have chosen to include equities, bonds (government, corporate investment grade and corporate high yield), bank loans, REITs to represent real estate, commodities and cash (all across a range of geographies). We use cross-asset correlations to determine which decisions are the most important.

Neutral allocations and policy ranges

We use market capitalisation in USD for major benchmark indices to calculate neutral allocations. For commodities, we use industry estimates for total ETP market cap + assets under management in hedge funds + direct investments. We use an arbitrary 5% for the combination of cash and gold. We impose diversification by using policy ranges for each asset category (the range is usually symmetric around neutral).

Expected/projected returns

The process for estimating expected returns is based upon yield (except commodities, of course). After analysing how yields vary with the economic cycle, and where they are situated within historical ranges, we forecast the direction and amplitude of moves over the next year. Cash returns are calculated assuming a straight-line move in short term rates towards our targets (with, of course, no capital gain or loss). Bond returns assume a straight-line progression in yields, with capital gains/losses predicated upon constant maturity (effectively supposing constant turnover to achieve that). Forecasts of corporate investment-grade, high-yield and bank loan spreads are based upon our view of the economic cycle (as are forecasts of credit losses). Coupon/interest payments are added to give total returns. Equity and REIT returns are based on dividend growth assumptions. We calculate total returns by applying those growth assumptions and adding the forecast dividend yield. No such metrics exist for commodities; therefore, we base our projections on US CPI-adjusted real prices relative to their long-term averages and views on the economic cycle. All expected returns are calculated in local currency and then, where necessary, converted into other currency bases using our exchange rate forecasts.

Currency hedging

We adopt a cautious approach when it comes to currency hedging as currency movements are notoriously difficult to accurately predict and sometimes hedging can be costly. Also, some of our asset allocation choices are based on currency forecasts. We use an amalgam of central bank rate forecasts, policy expectations and real exchange rates relative to their historical averages to predict the direction and amplitude of currency moves.

Definitions of data and benchmarks for Figure 3

Sources: we source data from LSEG Datastream unless otherwise indicated.

Cash: returns are based on a proprietary index calculated using the Intercontinental Exchange Benchmark Administration overnight LIBOR (London Interbank Offer Rate). From 1st January 2022, we use the euro short term rate, the UK Sterling Overnight Index Average (SONIA), the US Secured Overnight Financing Rate (SOFR) and the uncollateralised overnight rate for the Japanese yen. The global rate is the average of the euro, British pound, US dollar and Japanese yen rates. The series started on 1 January 2001 with a value of 100.

Gold: London bullion market spot price in USD/troy ounce.

Government bonds: Current levels, yields and total returns use Datastream benchmark 10-year yields for the US, Eurozone, Japan and the UK, and the ICE BofA government bond total return index for the World and Europe. The emerging markets yields and returns are based on the Bloomberg emerging markets sovereign US dollar bond index.

Corporate investment grade (IG) bonds: ICE BofA investment grade corporate bond total return indices, except for in emerging markets where we use the Bloomberg emerging markets corporate US dollar bond index.

Corporate high yield (HY) bonds: ICE BofA high yield total return indices

Equities: We use MSCI benchmark gross total return indices for all regions.

Commodities: Goldman Sachs Commodity total return indices

Real estate: FTSE EPRA/NAREIT total return indices

Currencies: Global Trade Information Services spot rates

Definitions of and sources for asset categories used in the asset momentum chart (Figure 1)

Based on monthly total return data for global assets in US dollars (unless stated otherwise). Calculated using spot price of gold, spot price of Bitcoin, BofAML 0-3-month US treasury index (Cash), BofAML Global Government Index (Govt), BofAML Global Corporate Index (IG), BofAML Global HY Index (HY), Credit Suisse Leveraged Loan Indices (Loans, with the global index constructed by Invesco Global Market Strategy Office as a weighted average of the US and Western European indices), JP Morgan CLOIE CLO AAA Indices (CLOs, with the global index constructed by Invesco Global Market Strategy Office as a weighted average of the US and European indices), GPR General World Index (REITS), S&P GSCI total return index for commodities (CTY), MSCI USA Index (MSCI USA), MSCI ACWI ex USA Index (MSCI ex-USA), Credit Suisse Hedge Fund Index (H Funds), LPX Major Market Listed Private Equity Index (Priv Equity), Bank for International Settlements Nominal Broad Trade Weighted US Dollar Index (USD) and US Consumer Price Index (US CPI). Data is sourced from LSEG Datastream and Bloomberg.

Investment risks
The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

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