Home > Insights > Market views

Market View
How have markets digested US tariff proposals?

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At a glance

Sweeping tariffs cause global equity volatility

Sell off shifted from discriminate to indiscriminate

Relief rally provides select opportunities for long-term investors

The past week, we have seen President Donald Trump's widespread tariffs cause extensive volatility on equity markets globally. The news is changing rapidly but, after an historic advance on Wednesday, markets are above the levels we saw earlier in the week. In this article, we're going to take a closer look at the sell-off, how it affected sentiment, the ensuing relief rally and what's next for investors.

On 3 April, we witnessed a discriminate sell-off, when investors are selective about which assets they're selling. There was dispersion between sectors. IT, energy, financials and consumer discretionary sectors all experienced significant declines, dropping by 5% or more, while defence, utilities and consumer staples held up reasonably well, as these are seen to be somewhat resilient to tariffs. There was a geographical dispersion as well, with the S&P 500 falling by 5% compared with the UK's FTSE 100's -1.5% decline and Japan's Topix Index's -3% drop. Crucially, government bond yields fell as investors moved into safer assets.

The nature of the sell off changed on Friday after China retaliated with a 34% tariff on all US imports. The sell-off shifted from discriminate to indiscriminate, when investors sell assets across the board, as fears of a global recession accompanied by higher inflation mounted. All asset classes were off on 4 April, with the best performing sector down by -4.8% and the worst down -5.2%. The geographical dispersion from the day before also ended, with all equity markets globally experiencing declines.

Sentiment turned extremely negative. On 7 April, some 85% of the S&P 500 companies traded at four-week lows; the small-cap Russell 2000 Index reached four standard deviations from trend, which means it fell far lower than what is normally expected based on historical trends; gold sold off; and there was significant short ETF interest. Extreme sentiment and positioning such as this created the environment for the sharp rally we witnessed on Wednesday.

When risky assets behave in risky fashion, it is part of the investing journey. When assets thought of as safe behave in risky fashion—in this case, US government bonds—it is more concerning. Two things mitigate our apprehensions here. First, the Federal Reserve (Fed) is in a good position to ensure functioning markets by buying Treasuries if necessary, like when the Bank of England (BoE) bought gilts after the 2022 minibudget. Secondly, it is in this acute phase that the solution is found. It has been widely reported that the increase in bond yields persuaded Trump to change path and announce a 90-day pause on higher-band tariffs with the exception of China. Markets are now demanding that he deescalates further.

So what now?

1. Stick to the plan

The S&P 500 experiences a 20% decline on average every three-and-a-half years. Each one has its on own unique features, and there are always factors that make them seem worse than the last. But they happen so frequently that they are part of the plan when are assessing our client' risk tolerances. Trying to aggressively time markets is futile. Historically, the best days for market returns occur at the times of greatest stress. Missing those days is surprisingly damaging for investor returns.

2. Expect more volatility from here

In the same way we preach the benefits of remaining invested, we also guide against getting too excited on days like 9 April. We are in a period of great historic change as we move very quickly from a unipolar world dominated by the US to a multi-polar world with the relative emergence of China and Europe. Markets have been through these transitions before and generated returns, but it is important to avoid chasing up days too aggressively or expecting the geopolitical situation to be 'solved' in the short term. This volatility means it is good to be conscious and active about what you own.

3. Look out for areas that have been unfairly punished by the market

Before this sell off, what were the areas you wished you owned more of but were concerned you were too late? Capitulation – when investors sell off all assets in unison – offers an indiscriminate reset, which can create long-term opportunities. In aggregate, equity markets outside of the US are now trading at 12.3 times forward earnings, at lower levels than at any time over the last five years outside of the lows in 2022 and 2020. We believe this could present selective prospects.

About the author

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Tom is Head of Portfolio Strategy at LGT. He has over 15 years' experience managing multi-asset class private client and institutional portfolios, having previously been an Executive Director and Senior Portfolio Manager at Julius Baer.

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