VIEWS | FIRST QUARTER 2025

Quarterly economic outlook: The new world (dis)order.

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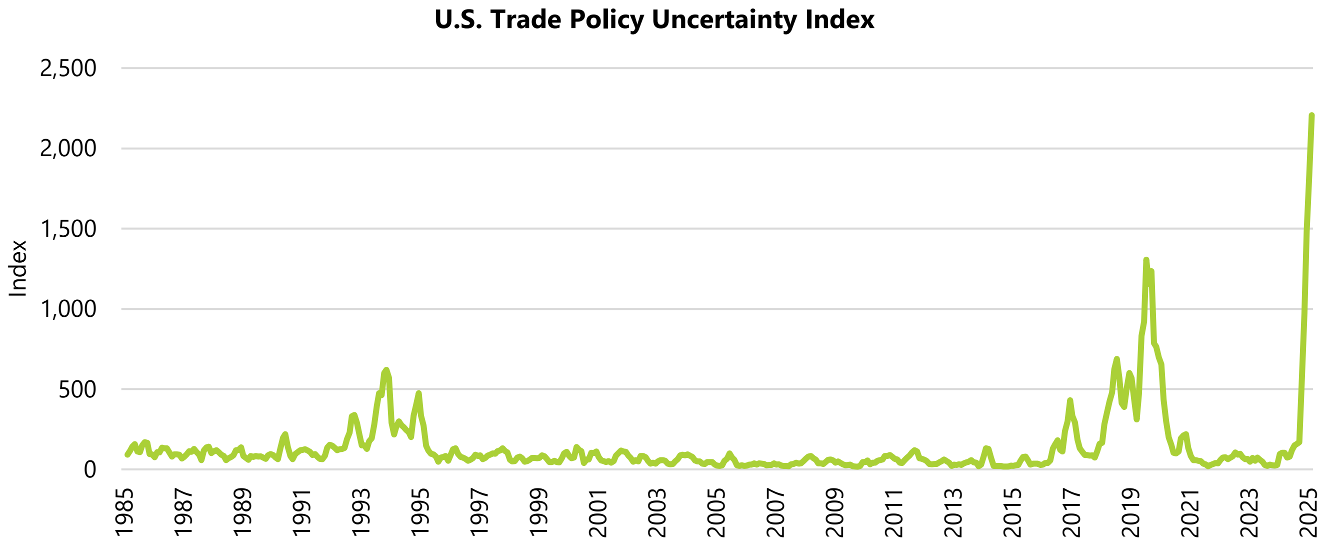
In the year 1980, Merrill Lynch started running what would become a famous commercial[1] showing a bull slowly walking through a China shop without damaging a single piece of stemware. By contrast, during the first 100 days of his presidency, Donald Trump has imitated a bull rampaging through the place and rapidly breaking things.

For investors, the immense uncertainty generated by the administration's tariff threats against friends and foes alike (highlighted in Exhibit 1) has been quite unnerving. The optimism that greeted Trump's election has been completely unwound, with U.S. equities falling into correction territory.

Exhibit 1: Upsetting the apple cart—and then slapping a tariff on the cart



Source: Economic Policy Uncertainty, SEI.

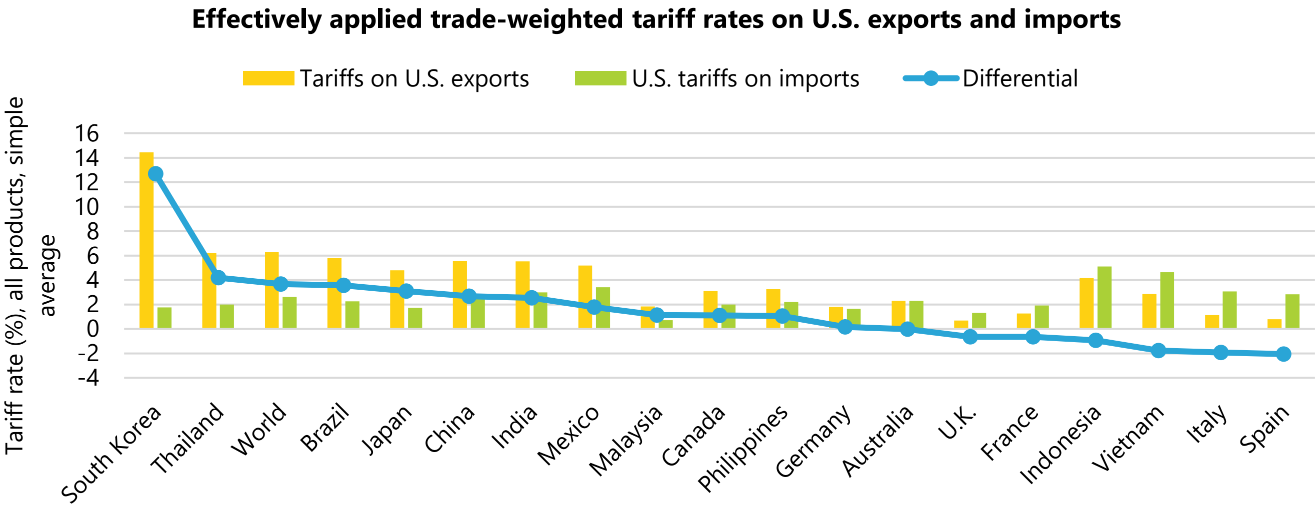
Trump's trade tactics have aggravated the situation, announcing tariffs one day and canceling them the next, only to put them back on later. As of this writing, 25% tariffs have been placed on aluminum and steel against all countries; China faces a 20% tariff on its goods on top of tariffs already in place since Trump's first term. On March 26, a 25% tariff was placed on imported cars and auto parts effective April 3, although USMCA-compliant vehicles from Canada and Mexico will face duties only on their non-U.S. content while USMCA-compliant auto parts will remain tariff-free. Since the mechanisms to track non-U.S. content still needs to be created, vehicles from these two countries will likely remain exempt from tariffs on a temporary basis. When fully implemented, however, the average tariff on U.S.

[1] Available at paleycenter.org/collection/item/?q=your&p=93&item=AT81:1257.

imports could rise to more than 12%, up from an estimated 2.5% at the end of 2024, marking the highest level since 1941.

The main tariff event, however, is scheduled for April 2—albeit with uncertain and imprecise messaging coming from the Trump administration—with either a so-called "reciprocal tariff" or a universal tariff to be placed on all U.S. trading partners. Exhibit 2 compares the disparity in tariff rates (a trade-weighted average across all products) imposed on U.S. exports versus the tariffs applied on imports into the U.S. Although the latest available figures only go up to 2022, they give a clue as to which countries might be subject to relatively higher tariffs. South Korea, Thailand and Brazil, for example, impose higher tariffs on U.S. goods than the U.S. imposes on their imports. For the world, the average disparity in tariff treatment amounts to about 3.7%. We view this number as a minimum baseline for a universal tariff, although there is speculation that a 20% levy might be imposed across the board.

Exhibit 2: Reciprocity or a recipe for disaster?



Source: World Integrated Trade Solution, SEI. Data as of 2022.

Given the Trump administration's rhetoric, it might be surprising to learn that several trading partners actually impose a lower effective tariff on U.S. exports than the U.S. imposes on them. These include some European countries such as Spain, Italy, France, and the U.K., as well as Vietnam and Australia. According to Oxford Economics, an economics consultancy firm, the imposition of the 25% tariff on autos will by itself push the effective tariff rate on imports from Japan and Korea to roughly 10% and to 12% for U.S. imports from the European Union.

The tariff differential with China is higher than most, but this doesn't tell the whole story of its relationship with the U.S.—which includes China's engagement in unfair trading practices. Most countries, including the U.S., have a host of non-tariff barriers. They include quotas, subsidies, health and safety regulations (such as restrictions on genetically modified foods), rules that require a foreign company to partner up with a domestic company, and bureaucratic hurdles that slow necessary approvals to operate in a country. We have no idea how the Trump administration will deal with these non-tariff barriers outside of saying that the more egregious examples will provide a rationale for imposing much higher tariffs on those countries.

Trump also sees value-added taxes (VAT) applied to U.S. exports as an unfair trading practice. That's not really the case. European auto manufacturers selling domestically, for example, are subject to the VAT—which they pass along to car buyers. While manufacturers get a rebate when they export to the U.S., car prices are then subject to whatever sales tax is paid locally. Recent pronouncements from Administration officials suggest that VAT differentials might not be targeted for reciprocal tariffs.

According to Trump and other administration officials, there are several goals behind this tariff war:

- *National security.* There is simply not enough capacity to produce the military equipment desired by the administration in the years ahead. The tariffs on steel and aluminum are framed as an attempt to encourage the onshoring of manufacturing capacity of those industries. Trump also wants to resuscitate an American shipbuilding industry.

- *Protecting the border.* Although Canada is unfairly lumped into the same basket as Mexico, there is no denying that Trump's threats have appeared to stanch the flow of migrants and fentanyl. Obviously, the animus displayed toward Canada goes beyond the drug and migrant issues. Some of this ill-will is based on the perception that Canada has not pulled its weight on defense spending. Economics also comes into play, with Trump wanting to see more car production in the U.S. and the end of tariffs on dairy products (Canada imposes a tariff as high as 300% on some dairy products that exceed a quota amount mutually agreed under the U.S.-Mexico-Canada Agreement during the first Trump administration).

- *Correcting economic imbalances.* In Trump's opinion, the structural trade balance (especially with China) is the reason for the decline in America's manufacturing prowess. He and the other trade hawks in the administration, led by advisor Peter Navarro and Commerce Secretary Howard Lutnick, want to "level the playing field" by imposing reciprocal tariffs and forcing a dismantling of non-tariff barriers.

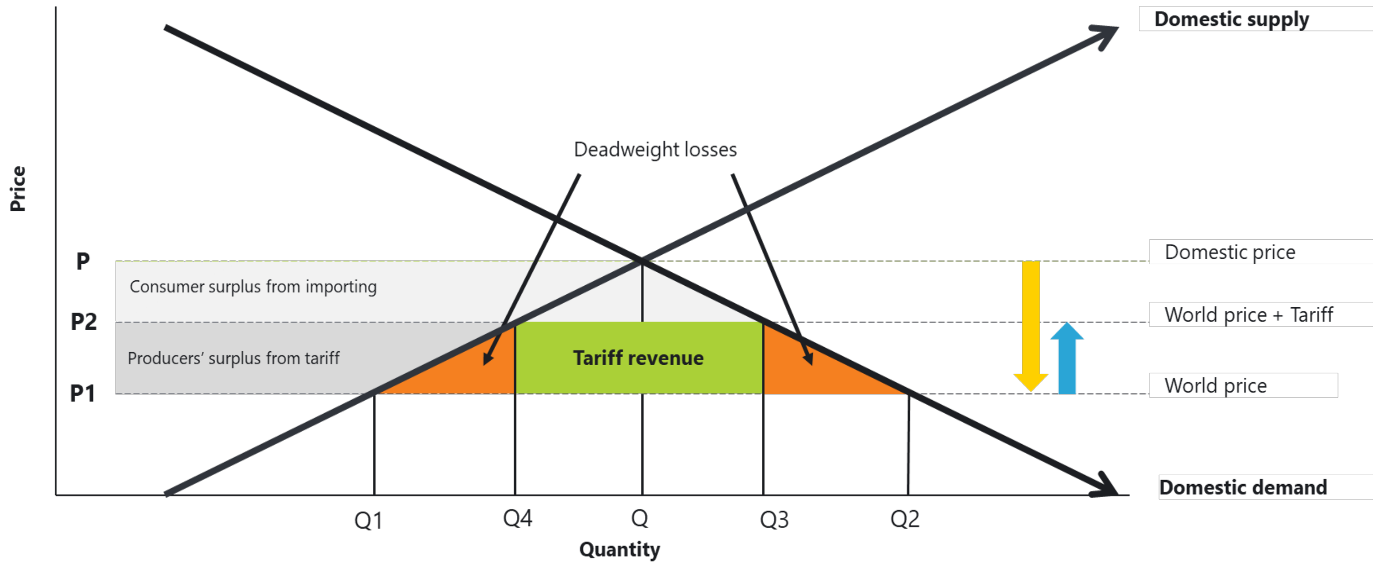
- *Encouraging the return of manufacturing to the U.S.* This applies particularly to autos but goes well beyond that industry. Trump wants to reverse the economic decline of the industrial Midwest, a section of the country that has been badly hit by the fentanyl crisis and other social woes stemming from the closure of plants and the loss of high-paying jobs for those persons with less than a college education.

- *Using high tariffs to compel North Atlantic Treaty Organization allies to spend more on their own defense.* European countries are already in serious discussions about raising their spending dramatically, although the threat of tariffs is less important than the perception that the U.S. might not be as willing to come to Europe's rescue militarily as it has been in the past.

- *Raising revenues to pay for additional tax cuts.* How high will tariffs be set? It could depend on how aggressively Trump wants to pursue his promises to cut taxes on tips, overtime and Social Security benefits. In addition, there is bipartisan support among members of Congress from high-tax states to raise the cap on deductions for state and local taxes (SALT).

This last point highlights the possibility that the law of unintended consequences could come into play, as tariffs are a terribly inefficient way of raising revenue. For those who have taken an introductory macroeconomics course, you might remember learning about the dead-weight loss that results from a tariff increase—which we illustrate in Exhibit 3. Prices go up and the quantity supplied goes down. The only winners are those companies and workers who are protected by the tariffs as well as the government that benefits from the increase in revenues.

Exhibit 3: Remember this from freshman year?



Source: SEI. For illustrative purposes only.

Imports increase the quantity of goods supplied to the economy (Q2 versus Q in the chart), while lowering prices from where they otherwise would be (the world price P1 as opposed to the domestic price P). A tariff forces prices higher (P2) and reduces the quantity of goods available for consumption (Q3). Domestic producers and the government benefit, but not as much as consumers lose (a deadweight loss).

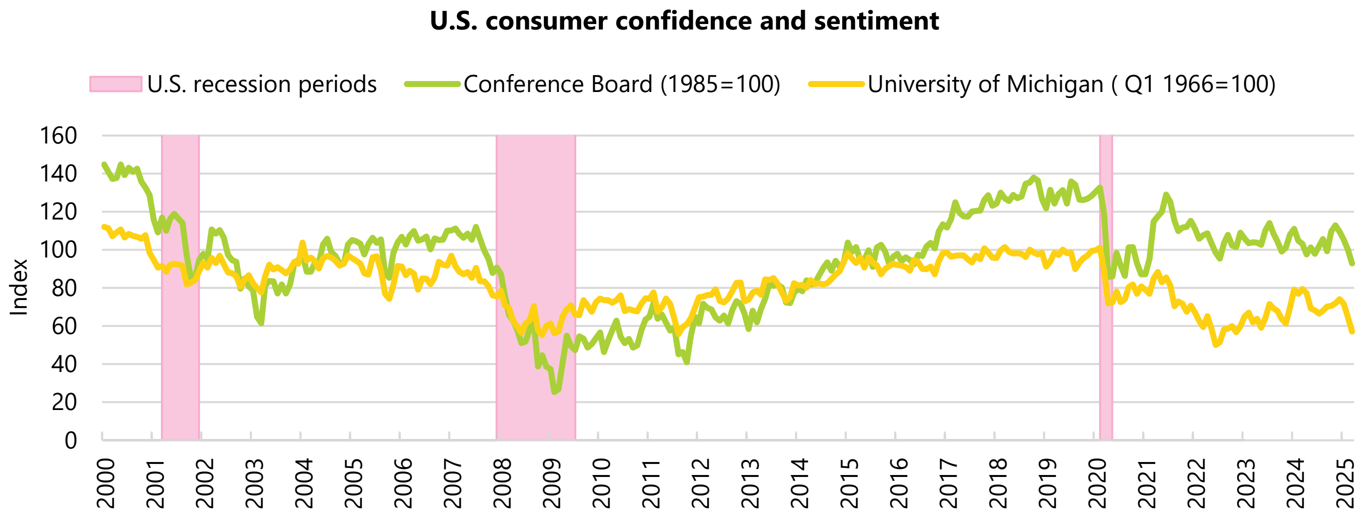
Just to pick one academic paper that examined the impact of the 25% tariff imposed on steel imports in 2018[2], the initial costs of tariffs were fully absorbed by importers and led to an increase in American steel industry prices about equal to the tariffs. Some $13.6 billion were transferred from steel users to steel producers, or $3.4 billion for each percentage-point rise in steel capacity utilization. A deadweight loss of $4.3 billion, or $1.1 billion per percentage point of increased utilization over the 15 months covered by the study, was also calculated. Employment at iron and steel mills and steel processors increased by a total of 6,874 workers; dividing that number by the total deadweight loss created by the tariff means that each job created cost steel consumers nearly $600,000 per year.

The capital-intensive nature of steel production explains why it is so costly to save jobs via tariffs. Other industries will experience the tariffs differently. Companies that have structurally low margins, such as food distributors, will likely pass through the costs of a tariff increase as much as they can or try to recoup the tariff by raising prices on other products not subject to the import duty. Companies that sport higher margins might absorb some of the tariff increase. Larger companies might be able to pressure some of their suppliers to swallow at least part of the tariff (note that China has already warned Walmart that it better not force Chinese suppliers to shoulder any of the burden). If Trump is true to his word, the application of universal tariffs will make it much harder to avoid paying the tariffs than was the case in 2018.

No U.S. recession—yet

Consumer confidence has taken a hit from all the tariff talk and from the radical restructuring of government operations in Washington, D.C., via Elon Musk and the Department of Government Efficiency (DOGE). However, as highlighted in Exhibit 4, consumer attitudes never really improved in the aftermath of the COVID pandemic—but that hasn't stopped them from spending. While we expect U.S. growth to slow from the healthy pace logged last year, we are not prepared to say that the slowdown will be dramatic.

Exhibit 4: Gloomy households



Source: The Conference Board, University of Michigan, NBERI, SEI.

For now, we think the U.S. economy can continue to grow close to a 2% pace through 2025. The first quarter outcome probably will be weaker than the full-year result, perhaps even down slightly. This year's opening quarter has been depressed by unusually cold weather, especially in the southern U.S., and by the Los Angeles fires. There also seems to be some payback following a rather strong holiday selling season late last year.

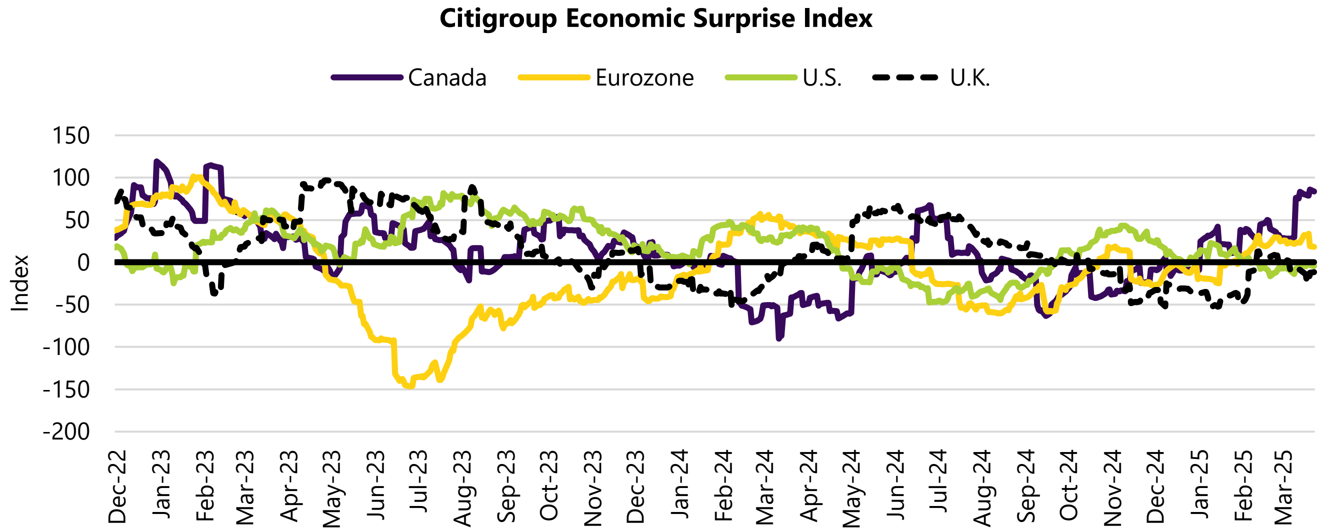
Most importantly, companies have stepped up their purchases of imported goods before the onset of tariffs—causing a surge in merchandise imports, which detracts from gross domestic product (GDP). While this should be offset by a similar gain in inventories and sales to end users, timing differences and measurement difficulties might make business activity during the first quarter look weaker than it truly is. Recall that professional economists were

[2] Kelly, Brian D. and Green, Gareth, The 2018 American Steel Tariffs: Incidence, Pass-Through, and Price Coordination (October 31, 2019). Available at SSRN: https://ssrn.com/abstract=3490345 or http://dx.doi.org/10.2139/ssrn.3490345

pessimistic about U.S. business prospects at the start of 2023 and 2024, both of which exceeded expectations. Until there is greater clarity regarding the timing, magnitude and duration of tariffs, we think it is probably best not to make any dramatic revisions to our U.S. growth expectations.

That aside, there is no disputing the fact that the U.S. economy is looking less exceptional nowadays. Exhibit 5 highlights Citi's economic surprise index (ESI) for the U.S. compared to Canada, the U.K. and the eurozone. The U.S. data delivered surprises to the upside during most of the fourth quarter, but it is now slightly surprising to the downside along with the data from the U.K. (which recently showed a slight 0.1% month-to-month decline in real GDP for January). Meanwhile, Canada and the eurozone beat fourth-quarter growth estimates. Movements in this statistic are subject to short cycles (lasting around six months). Note that the U.S. ESI has already bounced off its lows in recent weeks.

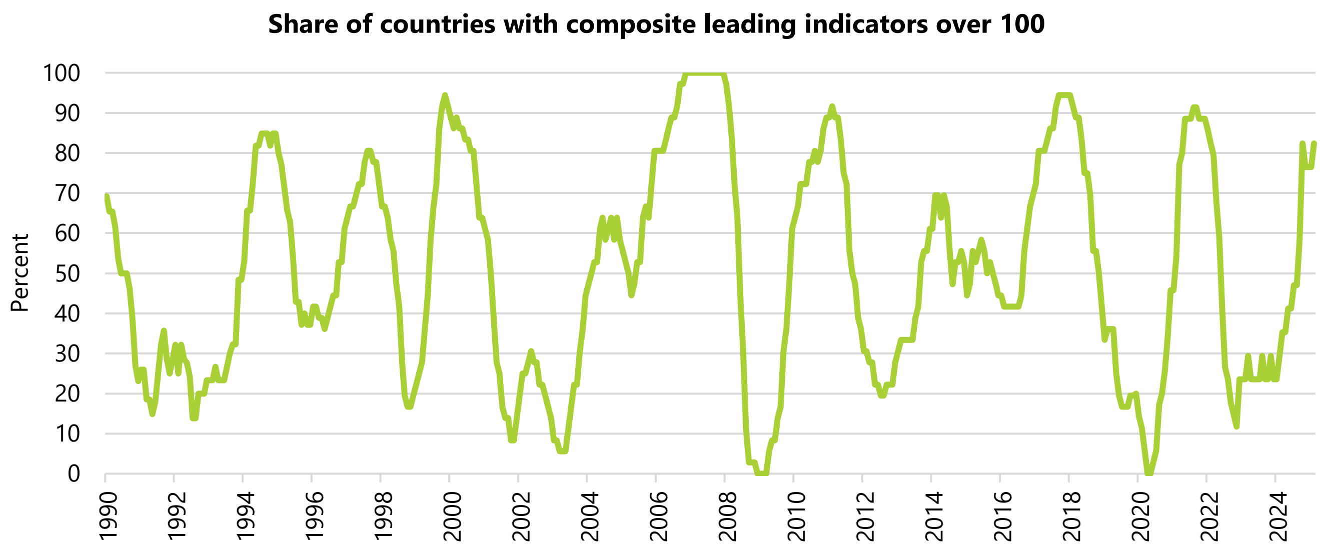
Exhibit 5: The U.S. loses its luster



Source: Citigroup, SEI. Citi's economic surprise index is defined as the weighted historical standard deviation of data surprises (actual releases versus Bloomberg survey median).

The Composite Leading Indicator (CLI) diffusion index, which is published by the Organisation for Economic Co-operation and Development (OECD), provides a broader perspective. As highlighted in Exhibit 6, it reveals that the world's largest economies were showing hints of improvement coming into 2025. The statistic tracks 12 major OECD economies plus five large non-member countries as of February. The percentage of countries reporting a CLI over 100 (indicating better-than-average growth ahead) is currently high, amounting to 14 out of 17 countries (82%). Of those 17 countries, 13 reported month-month gains in their CLIs as well as positive year-to-year changes.

Exhibit 6: Betting on better



Source: NDR, OECD, SEI.

We expect to see some deterioration in the OECD's measure because some of the "soft data" components, like share prices and sentiment, have lately turned negative for the U.S. and a few other countries due to Trump's disruptive trade tactics. Harder data, such as new orders, car sales and vehicles production could follow eventually if tariffs are set too high. On the positive side, labor data and services output should remain robust on a global basis. The encouraging data seen as of February suggest a certain resiliency still exists in the global economy even as countries brace for potential tariff-related stress.

Germany awakened

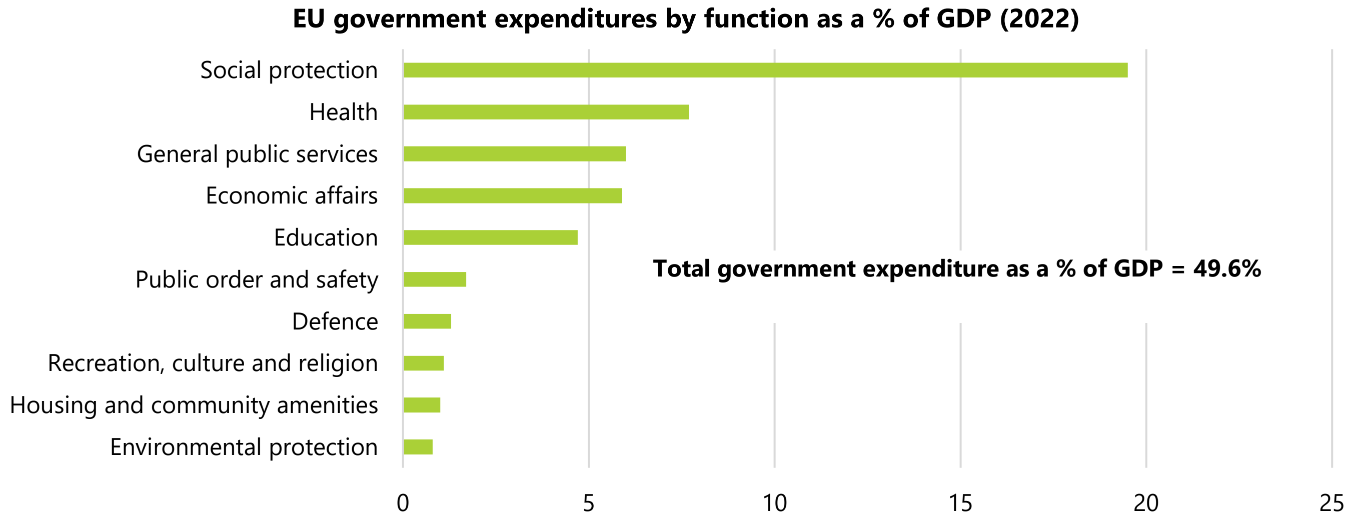
Trump's tough talk on tariffs and his administration's shift away from uncompromising support for Ukraine or NATO altogether have galvanized Europeans out of their complacency. The most important and potentially far-reaching change has come in Germany—which has finally loosened its fiscal straitjacket known as the debt brake—and will permit a surge in military spending in the years ahead. In 2022, it took Russia's full-blown invasion of Ukraine to finally push Germany's defense spending up toward NATO's 2% of GDP guideline. Now the threat of a downgraded U.S.-NATO relationship could potentially cause military expenditures to reach and even exceed 3% of GDP by 2030.

In addition to increasing military outlays, the German parliament has also voted to increase domestic infrastructure spending, creating a special off-budget fund of €500 billion that will boost spending by at least 1% of GDP annually over the next 10 years. At least 20% of the infrastructure fund will be used to further advance the country's environmental goals. Other uses include population protection, education, hospitals, and digitization initiatives. This "guns-and-butter" strategy has been welcomed by investors; the stock market, as measured by the MSCI Germany Index (total return), climbed nearly 11% in the year to date through the end of March in local-currency terms.

The positive market reaction stems from the fact that the German government's debt amounts to only 62% of GDP. France, by contrast, has a debt load that totals 112% of GDP; Italy is even higher at 135%. Most other members of the EU probably do not have the financial flexibility, or the goodwill of the markets, to opt for both increased military and social spending. Those countries would have little choice but to raise their defense spending if the foreign policy of the Trump administration seriously pivots away from the protection of Europe.

Exhibit 7 breaks down the general government spending (including state and local) of the EU by function. For the EU overall, expenditures amount to nearly half of annual GDP. By comparison, the U.K. is estimated to devote about 43.1% of GDP to general government expenditures (fiscal year 2025 estimate), while the comparable figure is 39.7% in the U.S. (as of 2024) and 40.6% for Canada (2023).

Exhibit 7: More guns, but keep the butter coming



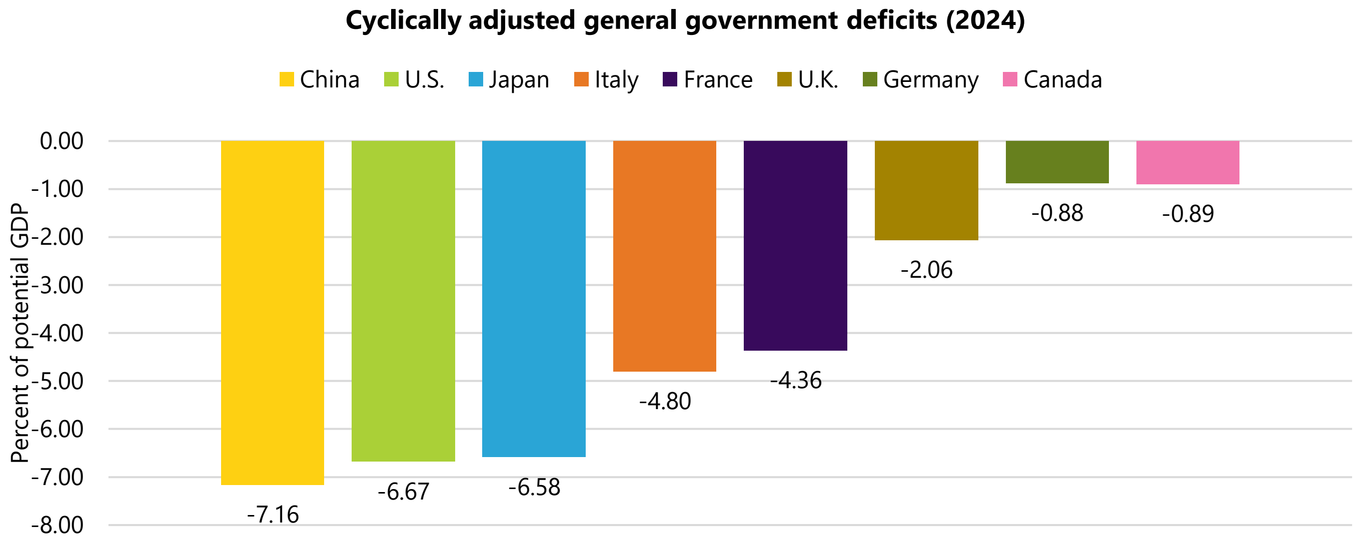
Source: Eurostat, SEI. Data as of February 29, 2024.

For all these countries/regions, spending priorities have been similar. Social spending has increased, owing to an aging population and the political decision to expand and enhance welfare benefits over time. Meanwhile, the share of defense spending has fallen dramatically following the fall of the Berlin Wall in 1989 and the collapse of the Soviet Union in 1991. The cost of financing the welfare state also fell by virtue of the secular decline in interest rates from double-digit rates in the early 1980s to near-zero rates a few years ago.

This combined peace-and-financing "dividend" has run out. Politicians will face difficult spending choices in the years immediately ahead as they deal with unfavorable demographic trends, higher interest expense, and the need to bolster their military capabilities in an increasingly fractious world. Those choices will likely be deferred for as long as possible. In the near-term, expect more guns and at least the same amount of butter. Fiscal expansionism is on the march. One modest exception to the trend is, surprisingly enough, the U.K. under the current Labour government. The so-called Spring Statement highlighted Chancellor of the Exchequer Rachel Reeve's determination to hold the line on spending following an Autumn Budget that raised taxes. The weak performance of the U.K. economy means revenues are failing to meet expectations. A trade war would undermine the government's deficit-reduction goals.

China also appears to be stepping up its fiscal stimulus by some 2% to 2.5% of GDP in an attempt to jumpstart domestic demand in the face of Trump's tariffs and a less friendly trading environment more generally. As we illustrate in Exhibit 8, China runs a cyclically adjusted deficit (calculated as if the economy were running at full employment) that's even higher than that of the U.S. But, as we seem to point out almost every quarter, the fiscal impulse has so far been insufficient to overcome the poor financial position of the household and local government sectors. Consumer sentiment remains stuck near its lowest level in 15 years, and the consumer-price level has declined on a year-over-year basis—meaning that the country is experiencing actual deflation. Outside of the COVID period, nominal GDP is growing at its slowest clip in more than 35 years.

Exhibit 8: China is a leading manufacturer of fiscal deficits



Source: International Monetary Fund (IMF), SEI.

Dodging DOGE

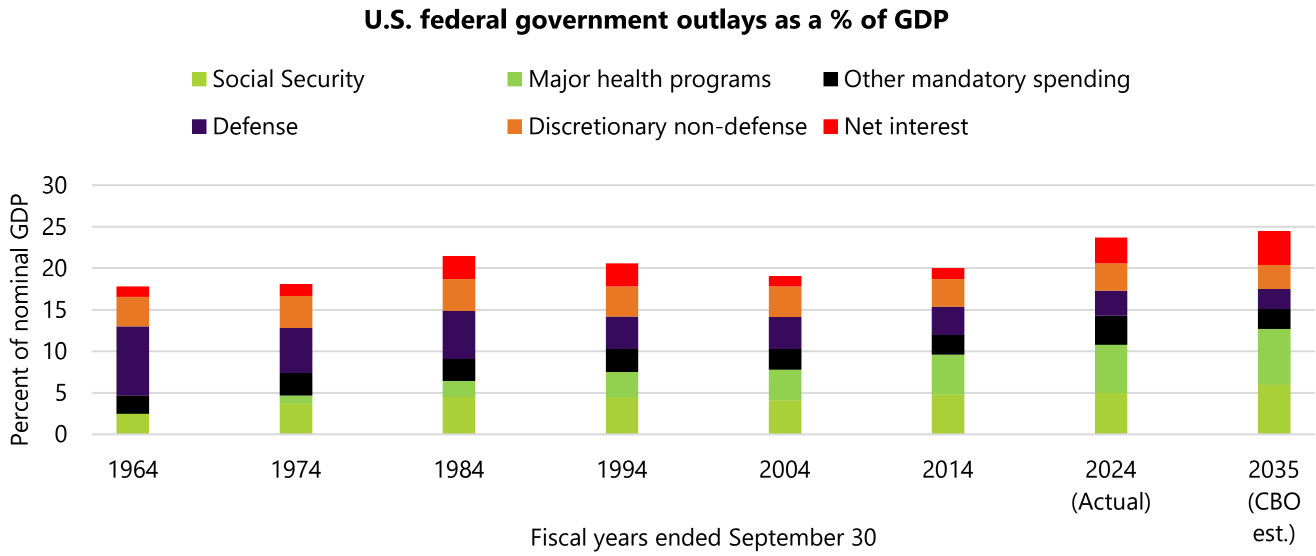
The U.S., by contrast, has been on a fiscally expansionary path for the past decade (some would argue since 1970 when deficit financing really kicked in). The highly controversial spending and employment reductions made by the DOGE team will have only a marginal impact on overall spending at the federal level. Judges are already rolling back some of those cuts, at least on a temporary basis, on constitutional grounds. It will take months for all of this to play out in court; even if the Trump administration enjoys more success than we anticipate in reducing the size of government, it is still something of a sideshow.

As of February, there were 159 million persons on U.S. nonfarm payrolls. Non-postal federal workers numbered 2.4 million or 1.5% of that total. Meanwhile, total government spending accounted for 23.7% of GDP in 2024[3]. Even a 10% reduction in force would have a limited impact on overall economic growth since the federal government is a huge cash distribution machine. As we highlight in Exhibit 9, most government spending is on autopilot. Social Security, the major health programs (Medicare, Medicaid, veterans' benefits) and other mandatory spending programs account for three-fifths of all federal government expenditures, or 14.3% of GDP. Net interest payments totaled 3.1% of GDP. Of the remainder, the pressure will be to raise military spending (currently 3% of GDP), not

[3] Bureau of Labor Statistics, U.S. Department of Labor. "Employees on nonfarm payrolls by industry sector and selected industry detail." Available: https://www.bls.gov/news.release/empsit.t17.htm. Accessed March 31, 2025.

reduce it in the years ahead. Non-defense spending (3.3% of GDP) is all that's left. Even an unprecedented 10% cutback would yield a reduction in direct government outlays amounting to only 0.3% of GDP.

Exhibit 9: Government spending will be hard to cut

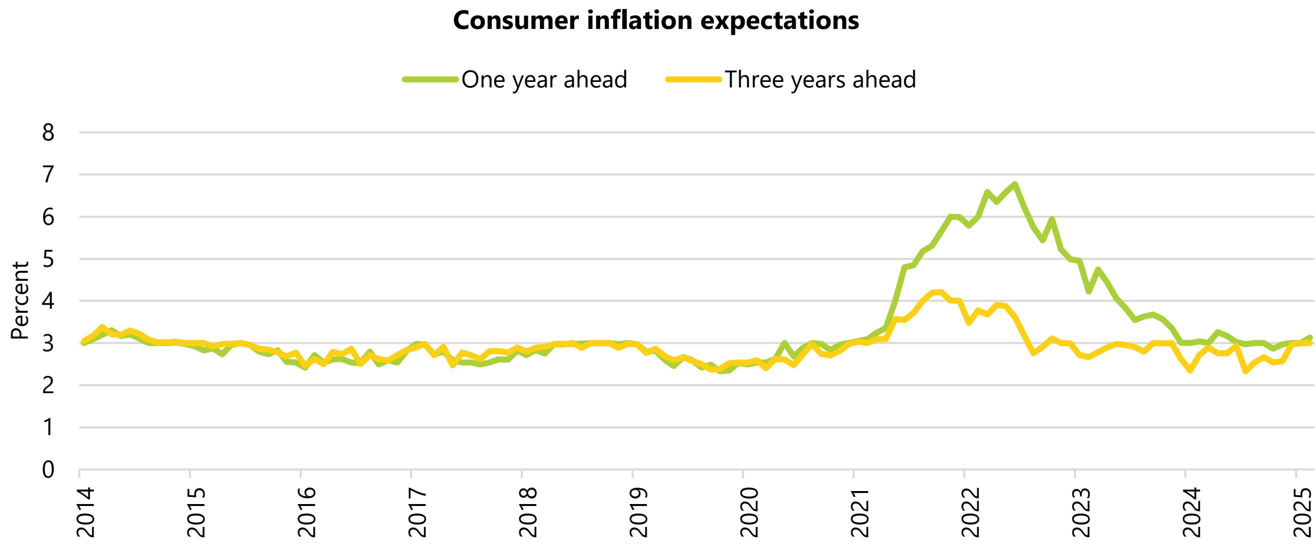


Source: Congressional Budget Office (CBO), SEI. As of January 2025.

A strong whiff of stagflation in the air

In theory, a tariff raises the price level as a one-shot deal. Federal Reserve (Fed) Chair Jerome Powell invoked the dreaded term "transitory" when answering a reporter's question regarding the inflationary impact of tariffs at his recent press conference. At least he didn't repeat the word three times. Whether transitory or not, people have been sensitized to high prices and the stickiness of services inflation. Exhibit 10 tracks consumer inflation expectations over the following one and three years, as surveyed by the Federal Reserve Bank of New York (FRBNY). Both have been ticking up in recent months and are likely to move higher in the months ahead on tariff concerns. Other surveys, such as those conducted by the University of Michigan and The Conference Board, reveal a much sharper rise. Powell went out of his way to downplay those surveys, indicating that the decisionmakers at the Fed are still operating under the assumption that consumers' inflation expectations are well-anchored.

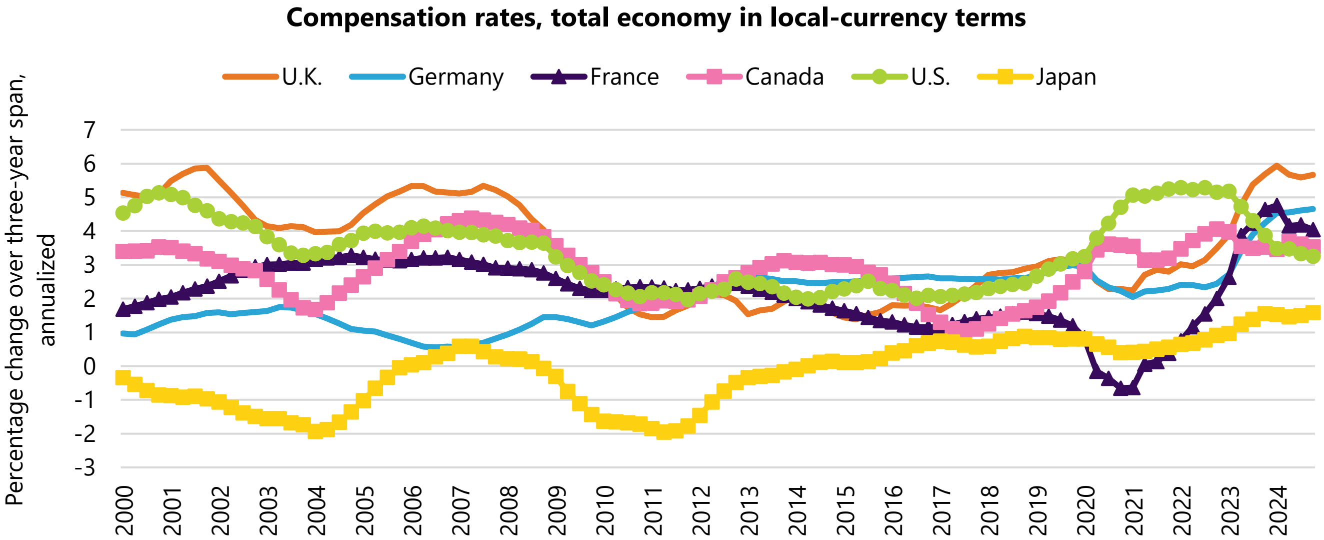
Exhibit 10: Inflation expectations may not stay anchored



Source: Federal Reserve Bank of New York (FRBNY), SEI. Data as of February 2025.

In a full-scale tariff war, marked by retaliatory tariffs imposed on U.S. exporters, the impact on prices would spread across countries. The longer the adjustment process to a higher price level, the less transitory that inflation would appear. We will be focusing on wages to determine whether a more sustained inflation is getting underway. As we show in Exhibit 11, the gains in workers' compensation rates have slowed significantly in the U.S. from the early post-COVID period. The three-year trend of deceleration has not been nearly as dramatic in other countries. The U.K., Germany, France, and even Japan, are all recording compensation increases that are faster than any other time in the past 25 years.

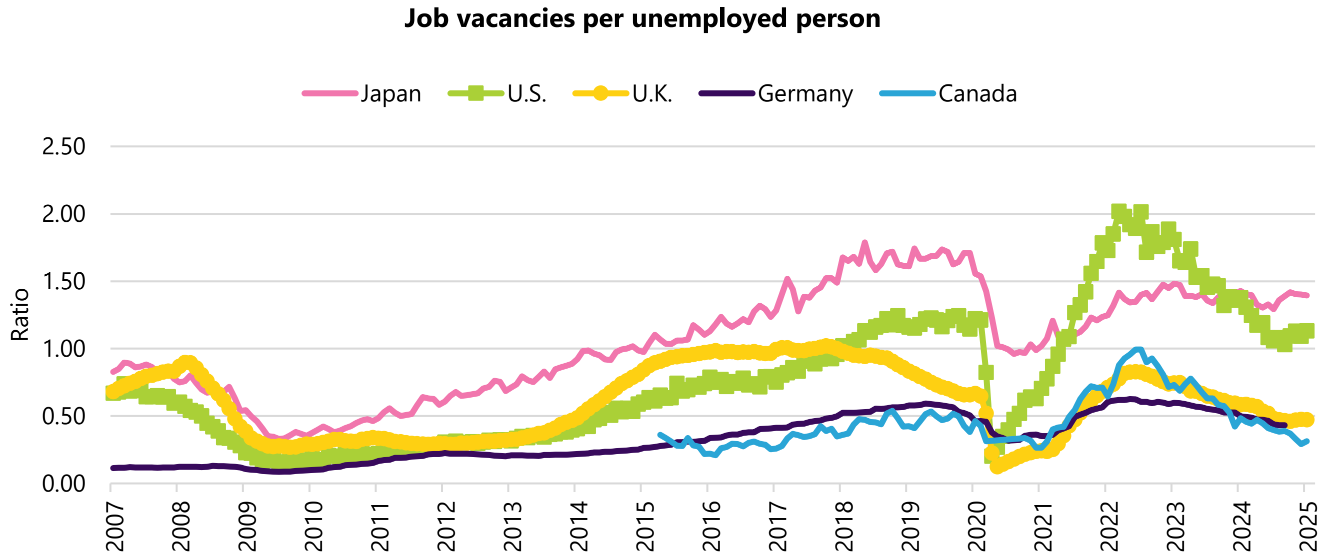
Exhibit 11: Not-so-small compensation



Source: Organization for Economic Co-Operation and Development (OECD), SEI.

On a more positive note, labor markets across the major economies appear more balanced than they were a few years ago. As we show in Exhibit 12, the number of job openings per unemployed person has declined in most countries since 2022. The U.S. has recorded a drop from the peak of two job openings per unemployed person to a recent low of one vacancy in September. There has since been a slight uptick, and we expect further increases in that ratio as the flow of undocumented migrants into the labor force is expected to fall dramatically; according to U.S. Customs and Border Protection, encounters and apprehensions at the southwest border in February were down nearly 90% versus the year-ago level.

Exhibit 12: Fewer jobs go begging



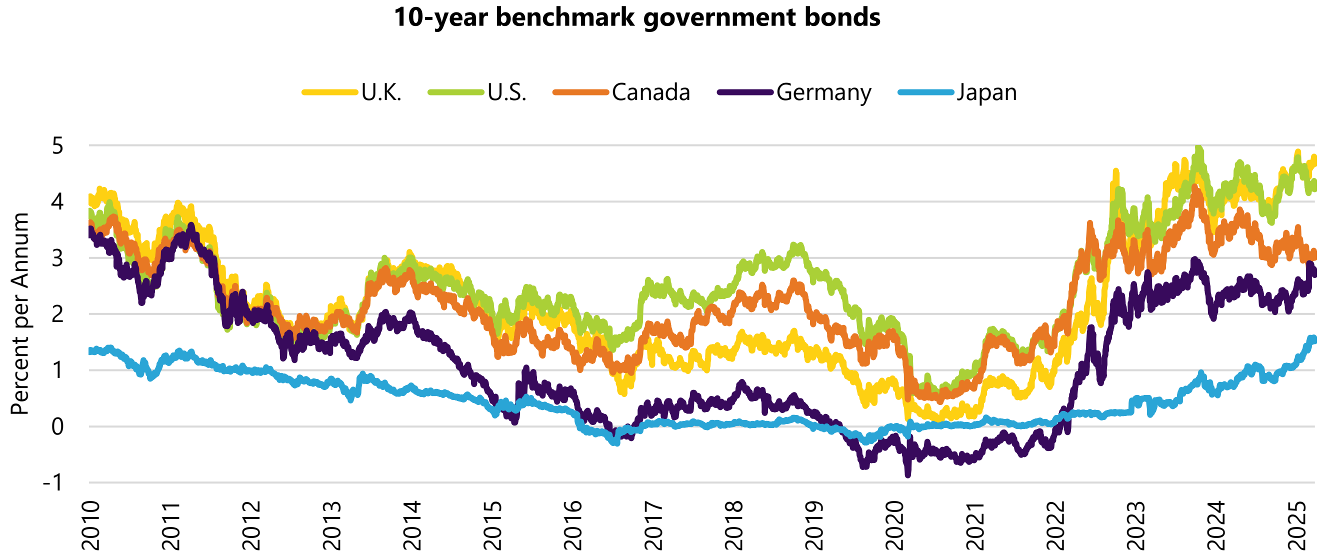
Source: FactSet, SEI.

One of our investment themes for this year has been a continuing divergence of central-bank interest-rate policies. This thesis continues to play out, with the Bank of Canada and the European Central Bank (ECB) each slicing another quarter-point off their respective policy rates in March, while the U.S. Fed, the Bank of England (BOE) and the Bank of Japan (BOJ) held rates steady. The BOJ is expected to continue raising its overnight rate in the months ahead; it is one of the few central banks in the world still in rate-hiking mode (the rest are less developed countries experiencing economic challenges).

That said, the policy divergence theme may now be entering its later stages. The ECB may become less eager to cut rates if there is a meaningful shift in European fiscal policy that sparks a more dynamic regional economy. A ceasefire in Ukraine would also be a positive. However, the impact of Trump's tariff war and its stagflationary potential need to be closely monitored.

International bond markets have responded strongly to Germany's move away from severe fiscal austerity, which we highlight in Exhibit 13. The 10-year bund yield spread against the U.S. Treasury 10-year has narrowed nearly 70 basis points since the start of the year. Japan has recorded a narrowing in its spread of 80 basis points against the U.S. benchmark bond. The Canadian 10-year yield, by contrast, has declined only 14 basis points versus the U.S. 10-year Treasury yield, while the spread on U.K. gilts has climbed this year by a notable 50 basis.

Exhibit 13: An a-bund-ance of yield

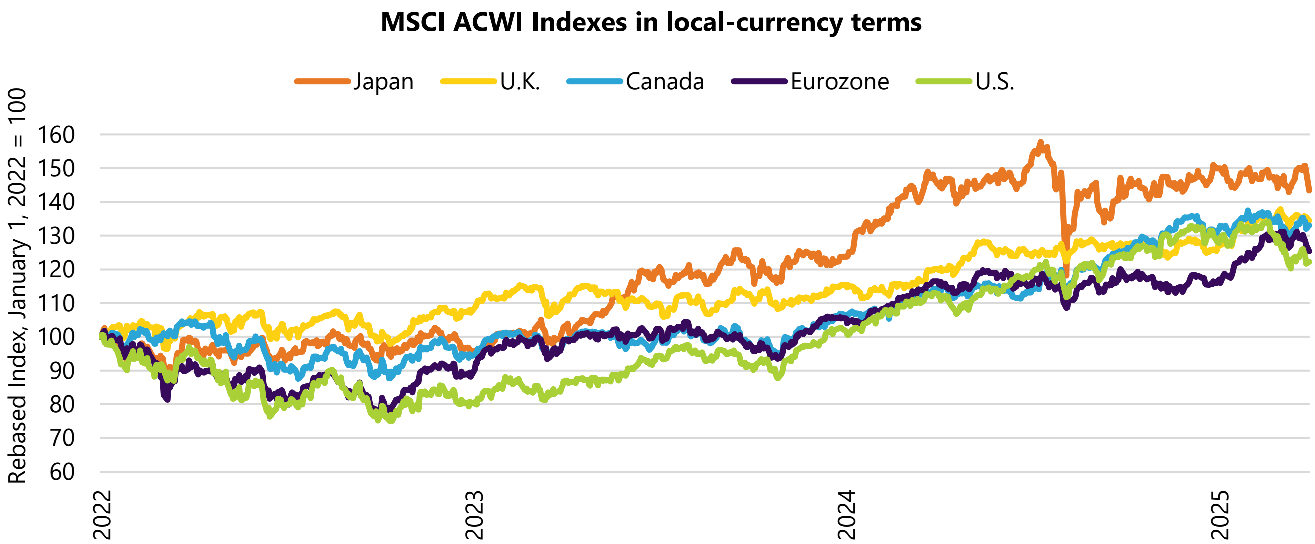


Source: FactSet, SEI.

The drop in U.S. yields to 4.21% at the end of March has gone too far given the inflationary pressures that we expect to develop in response to tariffs. We still expect the 10-year Treasury to trade mostly in a 4.25%-to-4.75% range this year. The U.S. dollar should also experience an oversold rally from its recent bout of weakness, although the move toward fiscal stimulus by Germany may require a reassessment of the longer-term currency outlook.

European stock markets also have enjoyed a sharp gain following the German elections and the expectation that the country's fiscal policy would become more expansive. In the year to date, the MSCI EMU Index (total return) has climbed 7.7% versus a 4.5% decline in the MSCI USA Index (total return). As we show in Exhibit 14, the U.S. measure has lagged other major bourses since the start of 2022 in local-currency terms. Granted, the MSCI USA Index suffered a sharp decline in 2022—but so did the MSCI EMU. If measured from the trough of the U.S. market in October 2022, the performance of the MSCI USA and MSCI EMU Indexes would be similar with a cumulative gain over the period of 62% for the former and 58% for the latter.

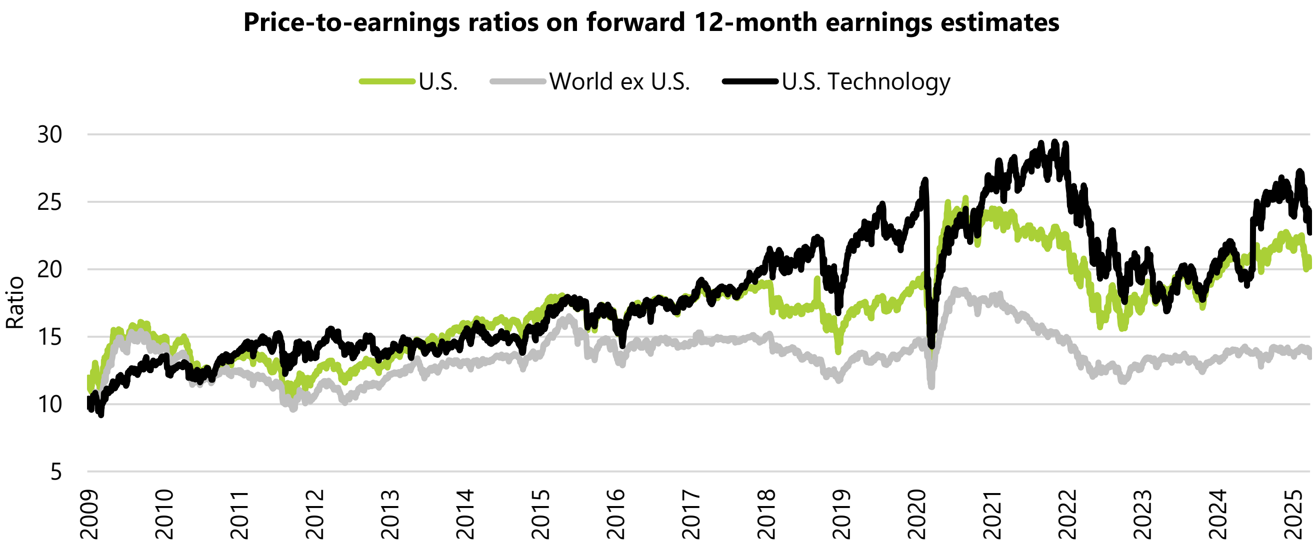
Exhibit 14: Nothing exceptional about U.S. equities since 2022



Source: FactSet, SEI.

This year's downturn in the U.S. stock market still leaves it on the expensive side, with a 12-month forward price-to-earnings ratio of 20.2 times, which we show in Exhibit 15. The U.S. technology sector has logged a sharp decline in its forward price-to-earnings ratio, falling from a January peak of more than 27 times to a current reading of 22.7. However, as recently as May 2024, the sector's price-to-earnings ratio was below 19 times—even cheaper than the total market at the time. Meanwhile, the forward price-to-earnings ratio for the MSCI World ex-USA Index has slowly risen off its October 2022 low but remains at a hefty discount to the valuation of the U.S. market.

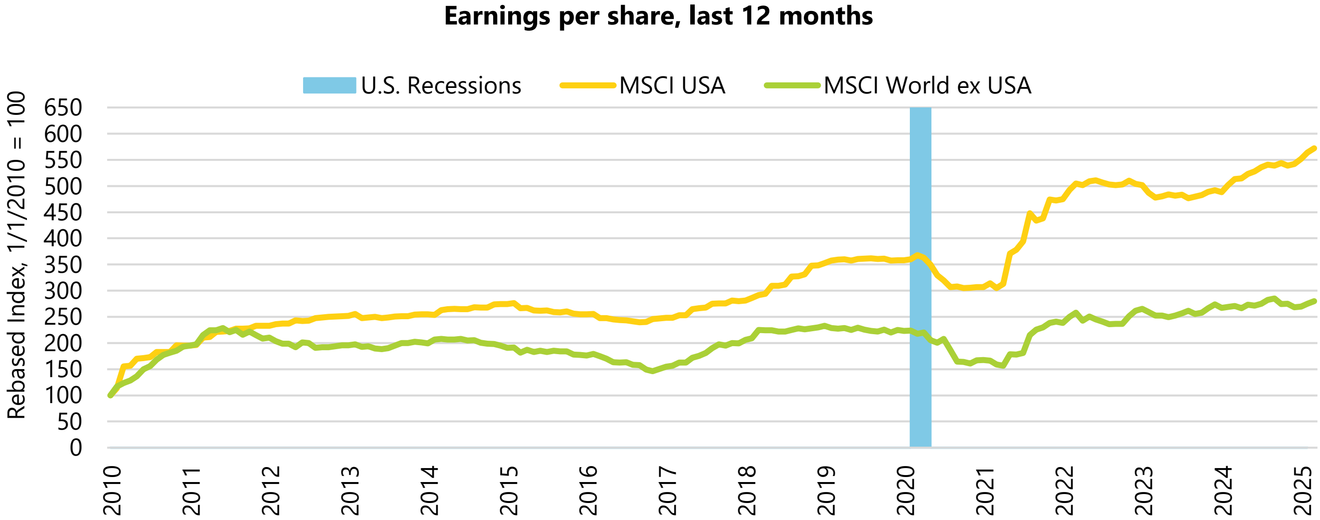
Exhibit 15: The U.S. stock market still carries a hefty price tag



Source: FactSet, MSCI, SEI.

The outperformance of developed equity markets versus U.S. equities this year is based on investors' perception that growth in earnings outside the U.S. will accelerate after a long period of relative stagnation. Exhibit 16 illustrates the extent to which the U.S. has outshone other countries over the past 15 years, with earnings per share pulling away from the pack starting in 2011. Over this period, actual earnings per share in the U.S. has climbed a cumulative 472% versus 180% for the companies that make up the MSCI World ex USA Index.

Exhibit 16. U.S. earnings leaves the rest of the world in the dust



Source: FactSet, SEI.

The start of that outperformance coincided with the European periphery debt crisis and extended through the rest of the 2010s as China's economic growth rate slowed under the burden of its debt pileup during the global financial crisis. During the latter part of the decade, U.S. growth stocks, led by the big tech stocks, also began their long reign of superior earnings growth. This outperformance accelerated massively in the years following the COVID pandemic and received another boost from Nvidia and the other "Magnificent 7" stocks in 2024. By contrast, the upward trajectory of profits in the rest of the developed world has not been anywhere near as dynamic.

No one knows if the correction in the big U.S. tech stocks and the bounce higher elsewhere so far this year will be sustained. But, as we try to point out in this report, there are straws in the wind that suggest a narrowing of the U.S. economic growth advantage. The uncertainty caused by the Trump administration's policy moves could be the catalyst for a reversal in the long trend of U.S. equity outperformance that has been increasingly concentrated in a narrow grouping of extremely profitable companies. Diversification outside the U.S. and a tilt toward value have become easier to defend.

A summary of our views:

- The optimism among U.S. investors that greeted Trump's election has been completely unwound as concerns over tariffs and the deteriorating relationships with U.S. allies take centerstage.
- Trump views tariffs as a tool that serves multiple purposes including border control, compelling NATO allies to spend more money on their own defense, correcting economic imbalances, encouraging the reshoring of manufacturing, and as a revenue source.
- Tariffs are an inefficient way to raise revenues and should cause prices to rise while restricting consumer choice.
- Although U.S. GDP will likely be weak in the first quarter, SEI still expects the economy to grow near 2% over the full year. This assessment is subject to a downward revision depending on the severity of the coming tariffs.
- Outside the U.S. there are signs that growth might be picking up. Germany's loosening of fiscal constraints should lead other European countries to do the same, leading to higher spending on defense and infrastructure.
- Although Elon Musk's war against government waste grabs headlines, the impact on overall U.S. government spending will likely be limited.
- Fed Chair Powell resurrected the term "transitory inflation" when describing the impact of tariffs on the price level. In theory, he is correct. But people are highly sensitized to rising prices, and a tightening labor market (the result of fewer migrants entering the labor force) could lead to a modest wage-price spiral that keeps inflation higher for longer.

- Central-bank policy divergence has been a long-running theme. It may continue for a while longer, but a more aggressive fiscal policy in Europe could make the ECB less eager to cut rates in the future.
- The drop in U.S. yields has gone too far given the inflationary pressures that we expect to develop from tariffs. We still expect the 10-year Treasury to trade mostly in a 4.25%-to-4.75% range this year.
- European stock markets have enjoyed a sharp first-quarter gain in reaction to the German elections and the expectation that fiscal policy would become more expansive. The outperformance of developed equity markets versus U.S. equities so far this year is based on investors' perception that growth in earnings outside the U.S. will accelerate after a long period of relative stagnation.
- It has become easier for investors to defend diversification outside the U.S. and a tilt toward value.

Glossary

10-Year Treasury yield represents the annual interest rate that the U.S. government pays on 10-year Treasury notes, serving as a key benchmark for other interest rates and a barometer of investor sentiment about the economy.

Bund is short for Bundesanleihe ("federal bond"); bunds are widely viewed as the German equivalent of U.S. Treasury bonds.

Germany's **debt brake** (also known as Schuldenbremse) means that the government may only spend as much money as it takes in, primarily from taxes and levies.

Gross domestic product (GDP) is the total monetary or market value of all the goods and services produced in a country during a certain period.

A "**guns and butter**" refers to the economic trade-off between spending on military (guns) versus domestic social programs (butter).

Magnificent 7 refers to a group of seven large-cap technology companies (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla) that have significantly influenced market indices like the S&P 500 due to their strong performance and market dominance.

A **reciprocal tariff** is a tax or trade restriction that one country imposes on another in response to similar actions taken by that country, aiming to create balance in trade by mirroring the tariffs or trade barriers imposed by the other nation.

Transitory inflation refers to a temporary or short-lived increase in the rate of consumer price rises, expected to revert to a steady rate, often caused by supply chain issues or other temporary factors.

Value-added tax (VAT) is a consumption tax assessed on the value added in each production stage of a good or service.

Index definitions

The **Citigroup Economic Surprise Index** measures the degree to which a core set of economic data series has been coming in under expectations, at expectations, or over expectations.

The **MSCI EMU Index** (European Economic and Monetary Union) captures large and mid-cap representation across the 10 Developed Markets countries in the EMU.

Composite Leading Indicator (CLI) diffusion index measures the proportion of countries whose CLI is rising or remaining unchanged, either month-over-month (MoM) or year-over-year (YoY). This provides insight into the health and directional momentum of the global economy.

The **MSCI Canada Index** tracks the performance of the large- and mid-cap segments of the Canada equity market.

The **MSCI Germany Index** measures the performance of the large and mid-cap segments of the German market. With 56 constituents, the index covers about 85% of the equity universe in Germany.

The **MSCI Japan Index** tracks the performance of the large- and mid-cap segment of the Japanese equity market. The index's 237 constituents comprise approximately 85% of the free float-adjusted (i.e., including only shares that are available for public trading) market capitalization in Japan.

The **MSCI United Kingdom Index** measures the performance of the large and mid-cap segments of the UK market. With 78 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the UK.

The **MSCI USA Index** tracks the performance of the large- and mid-cap segments of the U.S. equity market. The index's 624 constituents comprise approximately 85% of the free float-adjusted (i.e., including only shares that are available for public trading) market capitalization in the U.S.

The **MSCI World ex-USA Index** tracks the performance of the large- and mid-cap segments of equity markets across 22 of 23 developed- market countries--excluding the U.S. The index's 887 constituents comprise approximately 85% of the free float-adjusted (i.e., including only shares that are available for public trading) market capitalization in each country.

The **U.S. Trade Policy Uncertainty Index** measures policy-related economic uncertainty. we construct an index from three types of underlying components: news coverage about policy-related economic uncertainty, tax code expiration data, and economic forecaster disagreement.

Important information

The views contained herein are not to be taken as advice or a recommendation to buy or sell any investment in any jurisdiction. Our outlook contains forward-looking statements that are judgments based upon our current assumptions, beliefs, and expectations. If any of the factors underlying our current assumptions, beliefs or expectations change, our statements as to potential future events or outcomes may be incorrect. We undertake no obligation to update our forward-looking statements.

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