Capital Market Flash: stabilization within the week or bear market?

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Last week's tariff hammer has caused a setback in the capital markets, similar to what we usually see with sudden (external) shocks such as Covid-19, the Global Financial Crisis, or the Euro Crisis. It is currently unclear whether a rational international policy coordination with the USA will succeed, as it has in the past with (external) economic shocks. Without signals of rational economic policy cooperation and further actions from the "Orange Swan", we do not expect the stock market to stabilize quickly and, above all, sustainably!

Market reaction to tariff shock and reciprocal measures to date

Since Saturday, the US has effectively been imposing the "basic tariffs" of 10%. In particular, the erratic announcement of further severe unilateral additional US tariffs or "reciprocal tariffs" (effective from April 9) on 60 countries has triggered a **broad-based sell-off** of **risky assets** on financial markets over the past week as well as a flight to liquid safe haven assets, as we have seen in times of Covid. In line with traditional sell-off patterns, the current wave of selling could stabilize over the next two to three days. Nevertheless, the question arises as to when and whether we will soon see a sustained stabilization or even a V-shaped recovery. For a sustained recovery on the equity markets or an easing on the financial markets (rising yields), however, we would need to see a return to economic rationality in the coming days.

Almost as expected, **China** reacted directly to the US tariff escalation on Friday with vehemence. Overall, the Chinese reaction can still be seen as restrained and moderate, but still firmly in the spirit of a "great power policy". China not only imposed tariffs of 34% on all US imports, but also export controls/restrictions on rare earths to the US and placed other US companies on a list of unreliable companies (which prohibits exports and technology cooperation). Furthermore, China is obviously not currently prepared to find a solution to the dispute over the sale of Tiktok's US business. It may be waiting for possible tariff negotiations, while unilateral measures on the part of the US would be more likely to damage the US as an investment location. All in all, China's stance suggests that, as a state-controlled economy, it thinks it can sit out a tariff war more easily and for longer than the US.

Within the **EU**, there are — as to be expected — mixed and sometimes contradictory signals at national and supranational level. Some are calling for negotiations before drastic countermeasures, while others are calling for drastic and media-effective steps, for example on the basis of the Anti-Coercion Instrument (ACI). This set of instruments was created as a counter-reaction to economic pressure and coercive measures by another country. This geopolitical and geo-economic instrument (in itself intended for use against geopolitically distant countries) would enable comprehensive measures to be taken against US companies and/or their owners.

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It is important to emphasize that **China** and **Europe** have cultivated many (free) trade agreements around the world, and it is important that these remain intact.

In the **US** itself, the first public (protests) and institutional resistance to the Trump administration and especially the escalating US tariff policy is emerging. The state of California (approx. 14-15% of the entire US economy, for itself one of the largest economies in of the world) has announced ways and measures to circumvent the US tariffs. We believe that many more such drastic signals are needed before we can expect any foreseeable and partial concessions (including on the financial market). However, we do not expect any substantial concessions, as we believe that the Trump administration is concerned with a lasting change in the flow of goods as well as production and value chains in the international division of labor. In addition, the Trump camp's so-called "stick-to-itness" slogans are becoming increasingly common. We do not see reports from the Trump camp that many countries have signed up for (tariff) negotiations as calming the market as long as there are no prospects for credible negotiations with China, the EU and the G7 countries

Sustainable market stabilization will require signals of return to rationality

We believe that only **signals** of **economic rationality** (no further escalations by the US, start of robust talks between the US, China and Europe) will give the financial market a prospect of stabilization. Otherwise, there is still plenty of room for further market corrections at current valuation levels on the equity markets. It should be emphasized here that further US tariff increases are entirely conceivable in the event of countermeasures, that the Trump administration has other approaches to reshaping the international economic and currency system beyond tariffs and that currency issues, for example, are not yet part of the international confrontation. So there may be more to come.

Signals of early rational cooperation would include a suspension of the additional bilateral tariffs for at least 60-90 days, no further escalations and immediate talks between the US and China and the EU, or at least between the US and China for the time being (after all, the US and China account for just under 25-30% of global trade; including the EU, this ratio would even put us at 40-45%). If we do not see any relevant signals in the direction outlined above in the coming days, we will have to revise all of our current financial market forecasts. We believe that the experiences of recent years in Europe and beyond should have taught us all a lesson: In times of **geopolitics** and deep-rooted **populism**, we must **not rely solely** on **(short-term) economic policy rationality**.

Central banks should not act as market stabilizers for the time being

The leading central banks, the Fed and the ECB, have often reacted to (external) shocks with market interventions that were accompanied by tensions in individual financial market segments and/or substantial liquidity shortages. At present, however, we are not seeing any such market dislocations, just a "normal" financial market correction. In addition, the central bank balance sheets of the ECB and Fed (in relation to economic strength) are still higher than before the Covid-19 crisis and the supply of liquidity to the financial markets is still generous. Overall, in the short and medium term, i.e. over the coming days and weeks, we see no basis for central bankers to take immediate action to counter the threat of a Trump recession in the US. Furthermore, there is no threat of uncontrollable shock scenarios as long as the rest of the global economy remains in a cooperative mode. Rather, there is a threat of a noticeable slowdown in the global economy, possibly with a recession in the USA. As of today, WTO is predicting a decline in global trade of around 1%, while we were confronted with declines in global trade of -10% and -8% respectively in the context of the Global Financial Crisis and the Covid crisis. However, a central bank cannot initially derive any prospects for action from the deterioration in corporate earnings prospects associated with a significant slowdown in global trade – while equity market valuations remain high. Moreover, the **current market setback** is man-made, its roots are not within the banking/financial system and there is a clear prospect of a solution at political level. If so, **central banks** can only **act decisively this**

time if there is a sustained and **noticeable slowdown** in the **real economy** over the next **2-3 quarters** that clearly outweighs inflationary pressure stemming from recent US policy moves.

Current Market Situation - Fear of the "Orange Swan"

The US stock market experienced its worst week since the COVID-19 era (-9.1% for the S&P 500). **This sell-off continues unabated into the new trading week**. Asian markets are starting the week with losses ranging from -7% to -12%. The opening in Europe looks hardly more favorable (currently in the range of -5% to -7%), while US futures are also down by -4% to -6%. Simultaneously, European HY bonds widened by 60 bp, oil (Brent) is struggling with the $65/barrel mark, and even gold has seen slight losses. The market **fear indicator VIX tripled** within a trading week to 60, reaching levels last seen in 2020 (COVID).

The only refuge currently seems to be classic safe-haven products, such as government bonds and covered bonds. These remain in demand, providing room for further declines in yields of USTs and German Bunds. The 10-year government bond yields are currently trading below 3.9% (Treasuries) and 2.5% (Bunds). The narrowing at the short end was even more pronounced, and this flight to safety is likely to continue for now.

In principle, the large sums of money now passively invested in tradable stock market ETFs can make short-term market stabilization difficult. This is especially true in the case of a prolonged bear market not seen for a long time. The most relevant comparison currently seems to be the COVID-19 pandemic in 2020. However, the starting conditions are completely different. This crisis is demonstrably man-made (Orange Swan). Yet the **"Orange Swan" seems to be even more unpredictable than a virus**.

S&P 500 2020 (Corona) vs. 2025 (Trump-Tariffs)

Source: LSEG, RBI/Raiffeisen Research

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