# Trump's U-turns – rattle markets

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Donald Trump's increasingly aggressive tone over Greenland, combined with tariff threats against several European countries, defined happenings in the early part of the week. This led to a sharp rise in the political risk premium, which then eased partially towards the end of the week, following his backpedalling in Davos.

## Markets starting to price in a long-term political risk

US markets last week faced a triple salvo of political, bond market and monetary shots across the bow. The 10-year Treasury yield nudged 4.30% intraday. This was less connected with an immediate inflation scare than with rising doubts over the predictability of political decision makers amid the ongoing threats to the Fed's independence. On the macroeconomic front, incoming data continued to indicate a resilient economy. Core PCE inflation edged down slightly (-0.1%) to 2.7% year-on-year, but this remains above the 2% target. Meanwhile, real GDP growth in the third quarter was revised up to 4.4%. These figures have prompted markets to push back expectations of any rate cut until June, under a new-look Fed.

European markets were the most directly exposed to the geopolitical snowstorm last week. The dangling threat of punitive tariffs on eight European countries who had spoken out against the mooted annexation of Greenland, triggered a marked sell-off in the early part of the week. Luxury and automotive stocks, which are highly exposed to transatlantic trade, underperformed while defence stocks outperformed on expectations of higher military spending. Towards the end of the week, Trump's U-turn in Davos, whereby the use of force was ruled out and the spotlight shone on a future agreement on Greenland, gave indices momentum to rebound. This rebound does not, however, negate a more deep-seated trend as markets increasingly factor in a political risk premium, and one that is here to stay, arising from the now-customary instability in the rules of trade and diplomacy.

On the macro front, Eurozone inflation clocked in at 1.9%, below the ECB's target. In Germany, the ZEW index jumped to 59.6 points – its highest reading in more than four years – supported by a manufacturing stimulus plan

## Japan's debt causes angst

In Japan, attention focused on the central bank, which is increasingly losing its freedom of action. On 23 January, the BoJ kept its policy rate steady at 0.75%, as expected, but raised inflation and growth forecasts. It also stated it is open to enact further rate hikes later in the year. Inflation continues to flirt near 3%, which is well above the long-term target, amid the massive stock of public debt. This cocktail of persistently above-target inflation, gradual monetary normalisation and the new government's inclination towards fiscal stimulus continues to drive concerns over the sustainability of Japan's debt pile. In financial markets, this tension last week translated into heightened volatility in sovereign bonds.

The S&P 500 ultimately ended the week down by 0.42% and Nasdaq by 0.12%. In Europe, the STOXX 50 corrected by 1.35% and the SMI By 1.99%.

This week all eyes will be on the Fed, for its rate decision and news about Jay Powell's possible successor. In equities, earnings season will be in full swing.

### Swiss Market Index (SMI)

It looks like consolidation is continuing on the SMI, short of the 13120 mark. A breakaway below this technical point could provide impetus for the index to retrace towards 13000 in the first instance.

## Key data

| | USD/CHF | EUR/CHF | SMI | EURO STOXX 50 | DAX 30 | CAC 40 | FTSE 100 | S&P 500 | NASDAQ | NIKKEI | MSCI Emerging Markets |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Latest | 0.78 | 0.92 | 13'147.13 | 5'948.20 | 24'900.71 | 8'143.05 | 10'143.44 | 6'915.61 | 23'501.24 | 53'846.87 | 1'501.11 |
| Trend | ↓ | → | ↓ | → | → | → | → | → | → | ↑ | ↑ |
| YTD | -1.60% | -0.89% | -0.91% | 2.71% | 1.68% | -0.08% | 2.14% | 1.02% | 1.12% | 6.97% | 6.89% |

(values from the Friday preceding publication)