

Diversifying your income sources while tariff uncertainty dominates

It's forecasted a meaningful slowdown in global growth caused by the sharp increase in US tariffs on the rest of the world. In the US, this will play out as a stagflationary shock, although some monetary easing is still likely. For the rest of the world, this is a negative growth and inflation shock, into which central banks will cut rates.

The Framework of US Tariff Policies Under Trump Administration

In particular, investors are currently conditioning the outlook on the US imposing the following framework, which is close to what Trump promised on the campaign trail (the baseline tariff is the revenue raiser, the China tariffs are part of long-term decoupling, and the sector tariffs are the industrial strategy component):

- a 10% global baseline tariff (with limited retaliation);
- about half of the (currently paused) reciprocal tariff regime being reimposed;
- a 60% tariff on goods imports from China (with equivalent retaliation);
- 25% tariffs on Canada and Mexico, but with a carve-out for USMCA-compliant trade;
- 25% sector-specific tariffs on autos, metals, pharmaceuticals, and some other sectors.

This combination would represent an enormous increase in average tariff rates relative to the start of Trump's second term. Investors calculate that the weighted average US tariff on the rest of the world would be 18% in this scenario, up from 3%.

At the time of writing, US tariff rates are considerably above these levels, despite the 90-day pause of the reciprocal tariff element. In particular, the rapid tit-for-tat escalation in US-China tariffs has taken average US tariffs to perhaps 28%. This is a bigger increase than the Smoot-Hawley tariff increases in 1930 that may have worsened the Great Depression, and more like 1800s levels. If the reciprocal tariffs come back on (either fully, or in part as investors expect in the base case), or US-China retaliation keeps spiraling, this would move higher.

Uncertainty in Tariff Trajectories and Future Negotiations

It goes without saying that there is profound uncertainty around where tariffs go next. Even in the base case, investors would not be surprised to see considerable variability in tariffs along the path to the eventual base-case levels.

For example, the reciprocal tariffs could turn on and off as Trump tries to gain maximum leverage or even just as he gets frustrated

with how talks are progressing. After all, it may be difficult for most countries to deliver a reduction in their bilateral trade deficits with the US. Negotiations will also encompass complex issues in addition to tariffs, such as standards, tax rates, defence spending, and currency policy.

And the path to the assumed eventual reduction in US-China tariffs could run through bigger increases in the near-term, before any off-ramp is found. Other retaliation, say by the EU or Canada, could also be met with US tariff increases.

Downside Scenarios: Retaliatory Spirals and Trade Conflicts

So, there are many downside scenarios from here. For the purposes of building an explicit scenario distribution, investors think a representative "retaliatory spiral" downside could involve the full reciprocal tariff regime being re-imposed, well above 100% tariffs on China remaining in place, all the sector-specific tariffs remaining in place and expanding over time, and the USMCA free trade agreement fully breaking down such that all goods from Canada and Mexico are subject to a 25% tariff. The US average weighted tariff rate would be an enormous 45% in that scenario.

There would also be a more generalized increase in tariff rates between countries not even involving the US, amid trade redirection and anti-dumping measures.

After all, it is perfectly plausible that the 90-day delay on the reciprocal tariffs proves to be just that, and they are fully reinstated. And mutual intransigence, not to mention superpower rivalry, could mean that the currently absurdly high level of US and China tariffs on one another could stick around, move higher, and the trade conflict expand to include things like critical mineral export bans. In extremis, this downside could see significant selling of Chinese treasury holdings, or the US taxing foreign holdings of US treasury assets, which would also see enormous selling pressure.

This would represent the end of the global trading system as previously constituted, a global recession, very aggressive cutting cycles from major central banks, and central bank liquidity injections comparable to the Global Financial Crisis (GFC) response.

Upside Scenarios: A Potential Pivot Away from Tariffs

On the other hand, there are still upside scenarios from here. The Trump administration may end up chastened by the treasury market joining the sell-off in other US assets, rapidly deteriorating consumer and business sentiment, pressure from donors, and the

prospect of a big defeat at the midterms, leading to a more wholesale pivot away from tariff policy. A crucial feature of an upside would be firms and households gaining some certainty about the US and global tariff regime, even if it involved a still-high tariff level.

Again, an explicit “policy pivot” upside (which is only one representative scenario among many), might involve a 10% global baseline tariff, which is also the full extent of tariffs imposed on China, full carve-outs for some successful negotiators such as Japan, Israel, or even the UK, a full USMCA carve-out, but the sector specific tariffs left on. The US weighted average tariff rate may settle around 10%, which is broadly consistent with the old baseline scenario.

Per that previous baseline, US growth would slow somewhat from 2024, while inflation would be broadly unchanged above 2%, and the Fed would cut rates very modestly. Presumably, financial markets would rebound significantly in this scenario.

Economic Uncertainty and Downgraded Growth Forecasts

Returning to the details of the base case however, the rise in the average tariff rate, the big negative wealth effects from the equity market selloff, and all of this extreme uncertainty about where tariffs will go, will have significant economic impacts. Such a volatile policy and financial market environment makes economic planning for firms and households extremely difficult, and they are likely to pull back from large decisions around durable consumption, investment, and hiring while this uncertainty lingers.

Aberdeen Investment has therefore downgraded its global growth forecasts to 2.7% in 2025, 2.7% in 2026, and 3.1% in 2027. These are down a cumulative 0.8% from its pre- “liberation day” forecasts – which themselves incorporated a degree of tariff-induced slowdown.

It's now expected US GDP growth of 1.3% in 2025 year-average terms, down from 1.6% previously. A lot of that growth reflects statistical carry from the previous year, so it's more useful to look at the Q4-over-Q4 growth rate at the end of 2025, which is now just 0.5% in the forecast. Moreover, quarters of negative growth would not surprise investors. Indeed, investors think that the probability of a recession in the US over the next 12 months is around 50%.

The level of US GDP at the end of 2027 is 1.4% below pre-“liberation day” forecasts. If these tariffs are kept in place over the long run, the US economy will suffer from lower allocative efficiency and competitive pressure. So much of this decline represents a fall in potential growth and is not necessarily associated with a rising output gap.

Inflation Dynamics and the Federal Reserve's Dilemma

US inflation is set to be higher this year, at 3.2% compared to 2.9% previously, and the underlying rate is also likely to be stuck around 3%. This increase is despite the pre-tariff moderation in inflation that the very latest data point to, and the sharp fall in oil prices, which will send gasoline prices lower. Very sharp moves higher in the month-over-month rates as tariffs take effect should be expected.

This creates a policy dilemma for the Fed. Many policymakers have stressed the importance of keeping long-run inflation expectations anchored in this environment, so remain concerned that the Fed will not be able to deliver the degree of easing those markets have priced. Investors are forecasting two Fed rate cuts this year in the base case (from one cut previously), with the fed funds rate falling to around 3% by the end of next year. The degree of monetary policy easing would be much greater in full-blown recession scenarios.

The Case for Diversified Income Portfolios

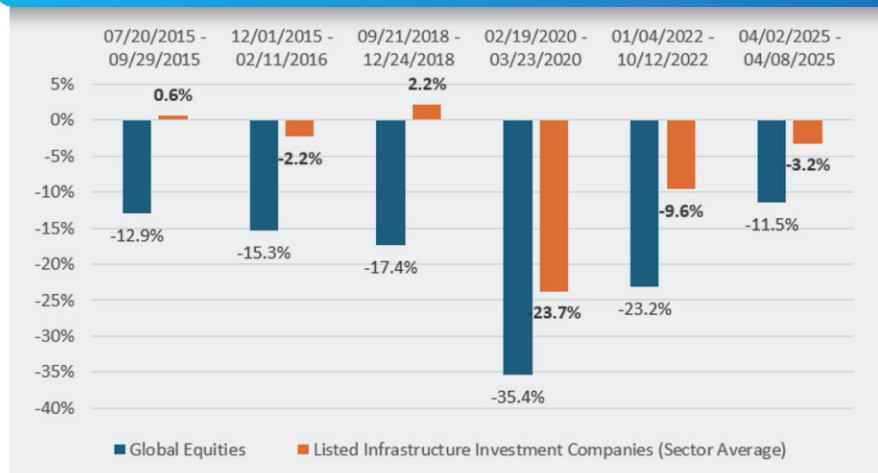
In today's uncertain world, investors seek portfolios that generate attractive long-term returns while providing resilience during market or economic stress. It's believed the solution is to invest flexibly across traditional and alternative asset classes, positioning portfolios towards the best long-term risk adjusted return opportunities. Diversified income portfolios invest extensively in listed alternatives, and particularly so in infrastructure. Aberdeen Investments access infrastructure in a liquid format via the UK investment company (IC) market. These daily traded closed-end funds have underlying assets that span wind and solar farms, schools, hospitals and data centres. Underlying assets typically benefit from long-term stable cashflows that are often inflation-linked and as such, these companies can perform well in a range of economic scenarios and prove resilient during periods of market stress. Admittedly, the onset of the Covid pandemic in 2020 saw a sharp dislocation between share prices and fundamentals, which resulted in greater beta to equity markets than historically experienced. However, this provided opportunities for investors who knew these companies well to increase positioning, and experience strong performance over subsequent years.

Not only do these companies provide significant diversification benefits but underlying returns are also compelling and further enhanced by the current discounts to net asset value (NAV) across the sector. These companies tend to trade at a discount or premium to their underlying NAV reflecting market sentiment, technical factors or discrepancies in perceived versus actual asset values. Currently, many ICs trade on material discounts to NAV which investors believe to be in part technical in nature. Investors think the sector is now poised for a wave of corporate activity that could drive significant re-ratings.

市場觀望

EYE ON THE MARKET

Chart 1: Infrastructure investment company performance during equity market downturns



Source: Aberdeen, Bloomberg, 10 April 2025, in GBP. As listed infrastructure investment companies are mostly listed in the UK, the return is shown in GBP or hedged back to GBP.

Written by Aberdeen Investments on 11 April 2025

Disclaimer: The above information is provided by abrdn Hong Kong Limited (the "Third Party"). The information was updated as of May 15, 2025. This document contains general information for reference only. This document is not an offer, recommendation, advertisement or invitation to buy any security or participate in a collective investment scheme. Since the above information and data in this document are obtained from a Third Party, any such information and data may be incomplete or condensed, may differ from the market environment, and is subject to change without further notice. YF Life Insurance International Ltd. ("The Company") makes no representation or warranty and accepts no responsibility as to the completeness of the information and data provided herein. The Company does not warrant that the above information meets your investment needs, objectives and risk-tolerance level. Should you make your investment decision relying upon the information in this document, you do so at your own risk. Any person considering an investment should seek independent advice on the suitability or otherwise on the particular investment. Investment is subject to market and exchange-rate fluctuations and to the risks inherent in all investments. The price of investment units may go down as well as up. Past performance is not indicative of future performance and yields are not guaranteed. No part of this document may be reproduced in any manner without the prior written permission of YF Life Insurance International Ltd.

China: Bringing the Long-Term Picture into Focus

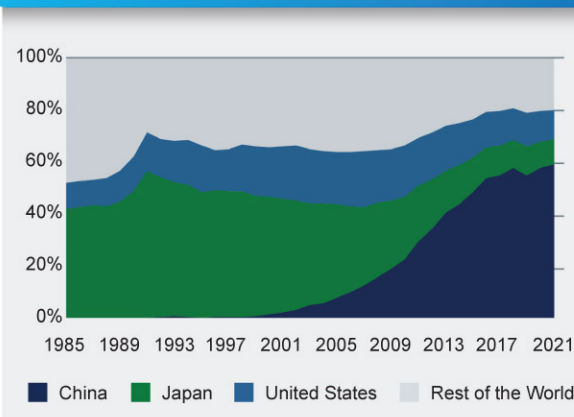
This year has seen a resurgence in market volatility following the introduction of trade tariffs by the Trump Administration, aimed at traditional allies and economic enemies alike. Not only are the tariff levels under negotiations and ever-changing at the time of writing, but the impact this has on the global macro demand environment remains highly uncertain, albeit skewed to the downside. On the other hand, in an attempt to de-escalate tensions, the trade talks in early May between the US and China in Geneva — marked the first high-level interaction between the two sides since Chinese Vice President Han Zheng attended Trump's inauguration ceremony in January. This followed admissions from the US that the two nations have a shared interest, and that the high level of tariffs between them are unsustainable. While the trade talks have made positive progress with both sides agreeing to significantly lower tariffs for 90 days, future discussions remain to be watched.

Despite the uncertainties ahead, which have caused global markets to stumble recently, long-term opportunities in equity markets continue to persist — and it's believed China remains one such case. This view is centred on four key principles, 1) China's Long-termism, 2) State support, 3) Domestic-led consumption 4) Valuations.

Long-termism

China's long-termism refers to its strategy of prioritizing long-term economic goals over short-term gains, often guided by five-year plans and its focus on sustainable development. A key long-term strategy has been a focus on technology, in what it calls the "New Quality Productive Forces", which includes leading edge fields such as artificial intelligence (AI) and robotics. The culmination of this approach has allowed China to keep pace. In particular, many industries now possess the technological edge and are well-positioned as technology leaders capable of significant innovation—where only a short time ago they were perceived as followers. This is best exemplified in two examples: firstly, in the sheer number of annual patents, where China in just two decades has moved to now represent more the 50% of global share (Figure 1), and in the disruption caused by DeepSeek's breakthrough AI model, which challenged the performance of western models and was developed at only a fraction of the cost.

Figure 1: Share of Annual Global Patent Applications



Source: WIPO, World Bank. As of May 2025.

It should be recognized that this shift has occurred when China was a rising power, adapting in a world dominated by a US hegemony. This long-termism theme should also therefore benefit going forward, notably in light of the recent shift in geopolitics where China is now positioning itself as the global champion of economic globalization. The seeds of this diplomatic campaign are already taking shape with President Xi visiting important regional trading partners in recent months, such as Vietnam, Malaysia, and Brazil. The diplomatic campaign underlines that for China, Trump's latest trade war is a critical moment — both as a chance to push back against US influence around the world, and for managing any dangers to its other export markets.

State Support

China has faced the dual pressure of property woes and an adjustment of its economic trajectory toward a new growth model. This economic shift, however, is a committed move toward higher quality growth, revolving around industrial production and the hope for greater consumption. Interestingly, in this transitional phase, big-bang stimulus had been notably absent. This change of tact reflected the variety of counter problems caused or worsened by large-scale stimulus in the past, which includes the increase in local-level debt, the heavy reliance on the property market, and the associated risks this created within the financial system.

Support to-date comprises substantive measures to support domestic exchanges last September, which included new funding channels and forward guidance from the central bank that the scale of support for stocks could be further expanded if needed*. The Two Sessions in March also reflected some changes in intent and determination, with the meeting emphasizing a re-embrace between the state and private enterprise—and its equity market—echoing the symposium held by President Xi with leading

市場觀望

EYE ON THE MARKET

tech business entrepreneurs in the private sector earlier in the year. Monetary and fiscal policies also remain supportive. For instance, in early May, there was further support in the form of cuts to both the policy rate and Reserve Requirement Ratio (RRR) for banks, along with expansion of the quota for re-lending tools covering sectors including technology, services consumption and elderly care, agriculture, and small and medium-sized enterprises (SMEs). Meanwhile, a number of companies have announced share buybacks in a bid to stabilize prices, which is also encouraged by the government.

Domestic Consumption

Up until recently, China had been steadfast in driving growth through coordinated state investment in what it has determined to be key industries: electric vehicles (EVs), batteries, and renewables. While this had supported growth, saturation of EVs and economic malaise in key markets such as Europe have led to diminishing returns. In addition, with property failing to normalize, China had become increasingly concerned that it will fail to meet its growth targets—placing economic stability and employment at further risk.

Additionally, retail sales have failed to rebound significantly. While cash savings at the household level have increased, consumption has not matched this fervor, leading to deflationary pressures within the economy. This is likely because property represents a significant proportion of household wealth, and as values have failed to stabilize, people therefore have felt increasingly less-well-off and reluctant to spend.

The government is acutely aware of this and has introduced targeted measures, which include interest rate cuts, help for homeowners, and the reconstitution of unfinished properties to social housing. The effects of this are now tentatively being felt, with property volumes showing evidence of stabilization—in particular, the recently announced Golden Week retail sales numbers have been strong, even in light of the poor external environment. In a world of rising uncertainty and trade disruption, having access to strong domestically-led drivers is hugely beneficial. This position is further strengthened considering that China is now coming out of a multi-year economic reset in a stronger position. In contrast, US economic data is just starting to deteriorate and consensus forecasts for earnings appear at odds with the current economic environment: high uncertainty, weak consumer and investor confidence, and elevated import duties.

Valuation

Starting points often are crucial when it comes to equity valuations. The current valuation of the equity market in China remains attractive compared to its history, which suggests the market is

positively exposed to even small earnings normalizations, let alone a pronounced economic recovery. However, it is likely that a corporate earnings recovery will be gradual rather than V-shaped, reflecting the steady pass through of current stimulus as it takes its time to weave through the economy.

Figure 2: China's Valuation Relative to Global Developed Equities



Source: MSCI, Refinitiv. As of April 30, 2025. China measured by MSCI China and Global Developed Equities measured by MSCI World.

In addition, it can be argued that returns to shareholders today look different to those of the past in China. For instance, a positive outcome of the recent economic woes has been the huge increase in dividend payouts and share buybacks—which are at all-time highs—with corporates having to refocus their attention on supporting minority shareholders in a bid to shore up their share prices. In addition to rising growth expectations, this should provide fundamental support to valuations.

Conclusion

Despite the recent returns in Chinese equities, the long-term case for the asset class remains attractive — supported by technological advancement, policy support, a resurgent consumer, and attractive current valuations. Given the variety of these drivers, it is important to have access to a broad array of Chinese companies and share types. In particular, the A-share market provides exposure to unique areas within technology, while the broader China and Hong Kong exchanges provide investors opportunities in sectors that are well-positioned to benefit from the recovery in consumer spending.

Source:

* Gongsheng Pan, Governor of the People's Bank of China, public address. As of September 2024