Broadstone

Market volatility following US tariff announcement

April 2025

Introduction

On 2 April 2025, the US announced tariffs it plans to impose on its trading partners. While the likely tariffs had been debated for many weeks, the announced rates are higher than many market participants had expected and has initiated a wave of disruption to global trade and financial markets.

We believe it is unlikely that trustees need to consider taking any immediate action. However, the market volatility we have seen (and the global press coverage) could continue for an extended period as negotiations and retaliatory actions play out, and we believe it would be prudent for trustees to consider any potential impact this could have, and any potential risks and opportunities that may emerge. In this note, we consider this market volatility in a wider context and the actions that trustees could take in response to this changing landscape.

Recent market movements

Gilts

The UK 15-year gilt yield has fallen to 4.8%, from 5.1% last week. All else being equal, a lower gilt yield will place a higher present value on a pension scheme's liabilities. However, many schemes are already hedging a large part of this risk within their investment arrangements and will therefore see some corresponding movements in their asset values.

This recent fall in yields should be considered in the context that during 2024 gilt yields rose from around 4.0% to 4.9% so yields are broadly back where they were at the start of this year, and most schemes will still have a better funding position today than they had at the start of 2024.

Corporate bonds

Credit spreads, or the additional yield available compared with comparable gilts, have widened in recent weeks. If market volatility continues, it would be reasonable to expect that credit spreads could widen further, and corporate bonds and other credit assets to underperform relative to comparable gilts.

This is in the context of corporate bonds outperforming comparable gilts over the last few years as credit spreads tightened, and in many markets, spreads remain tighter than historic averages. For many schemes, corporate bonds are held to maturity so short-term fluctuations in spreads and relative performance is less important, and they will also continue to provide an element of interest rate hedging and a source of predictable cashflows in many cases.

Equities

At the time of writing, European and Asian equity markets are trading up to 6% lower than before the announcement, and the US markets are trading up to 7% lower. Again, these market declines should be considered in a wider context, as pension schemes tend to be long-term investors. Global equity markets are currently trading around the levels last seen six months ago and have still generated a positive return over the last 12 months (and longer periods).

In addition, many pension schemes have been reducing their equity market exposure over time and so the direct impact is likely to be more muted in these cases.

Currency

While the US dollar has weakened slightly compared with Sterling, the exchange rate is still within the range it has traded in for the last couple of years. (Sterling's movement compared to other global currencies is more muted).

Many schemes' overseas fixed income and credit securities tend to be hedged back to Sterling, so the recent currency volatility is unlikely to have a material impact on these holdings. However, there will be some impact on allocations to unhedged overseas investments, such as overseas equities.

Risks and opportunities

What is unclear at this stage is whether this volatility is an isolated shock or the beginning of a more protracted period of volatility as the implications of the tariffs filter through the global economy. For example, there may be future negotiations that result in better or worse conditions than investment markets are currently pricing in. The implications are also complex to fully understand and work through at an underlying entity level, and the situation is likely to evolve with different impacts applying at a company, sector and regional level.

We will continue to monitor the emerging risks and opportunities across all the main markets highlighted above, and provide updates as required.

Potential actions for trustees

In our view, there is no need to panic, despite some of the alarmist headlines in the press. Therefore, **for most schemes we do not expect there is a need to take any immediate action**. Rather, we would reinforce the points we suggest below which apply in normal circumstances as part of a schemes' ongoing governance and risk management:

- **Monitor the liability hedging levels and rebalance as required:** When gilt yields are more volatile, the liability hedge ratios may deviate from their targets and introduce unwanted risks to a scheme.

- **Check the asset allocation and rebalance as required:** Significant movements in asset values can distort the asset allocation in relation to the target, leading to a scheme running more (or less) risk than desired.

- **Review any currency exposure:** If your scheme has material un-hedged currency exposure it may be appropriate to consider hedging some (or all) of the exposure back to Sterling.

- **Check your investment strategy remains appropriate relative to any changes in sponsor covenant:** Your investment strategy may not have performed as you expected during this period of market stress, so we believe it is sensible to re-confirm that the level of risk remains appropriate relative to your objectives. In addition, some sponsors which are more reliant on global trade may have suffered a deterioration in covenant strength, which again highlights the importance of reviewing the level of investment risk.

- **Review your liability hedging collateral waterfall:** If volatility in the gilt market continues, schemes with leveraged liability hedging funds should be prepared for capital calls and/or distributions from de/re-leveraging events.

After reviewing the points above, it may be that no action is required - particularly for low risk, well hedged schemes. However, for some schemes action may be appropriate in response to this changing landscape.

Find out more

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