



## **Shelter in a Storm**

MaxCap Group Research – May 2025

# Shelter in a storm



**A looming global storm.** In an uncertain market landscape, an unfolding trade war is impacting heavily on the outlook, potentially pushing the global economy into recession in the near term, and permanently reshaping trade and capital flows over the longer term.

**Fright and flight.** Capital markets around the world have reacted abruptly to this outlook, with sharp pullbacks in share and bond prices, along with big jumps in market volatility. There is nuance in this market, with some regions (like the US) being more harshly affected.

**Bracing for impact.** As with prior cycles, offshore shocks will have local impacts. Higher US tariffs will slow export demand for both China and Australia. Arguably, the larger impacts will come through financial channels, given reduced wealth and diminished confidence.

**Timely shock absorbers.** In previous downturns, there were well-honed shock absorbers at work in Australia. Lower rates would boost domestic sectors. A weaker currency would provide a competitiveness boost for exporters. Most of these shock absorbers are at work again.

**Finding a harbour in rough seas.** For investors, the lack of portfolio diversification is particularly concerning. In 2025, much like 2022, the traditional mix of stocks and bonds is not providing adequate portfolio stability. Investors need to look elsewhere for shelter in a rough storm.

**Finding your way.** More than ever, investors are looking more broadly to rebuild diversification and sustain returns. Portfolios are reallocating from public to private markets and from equity to debt exposures. Private credit remains well placed to offer that resilience.

# Island of stability

In the words of JRR Tolkien's Treebeard from the Lord of the Rings, '**the world is changing**'. A rapid escalation in the global trade war is impacting on the economic outlook, potentially moving the world into a recession in 2025 and a structural decline in trade over subsequent years.

- The on-and-off-again pronouncements of US **import tariffs** – with unpredictable degrees of severity and conviction – have drawn a predictable pattern of retaliatory tariffs from other countries. All of this has significantly increased investment market risk and uncertainty.
- In the near term, we are seeing **chaos in global trade**. Shipments of goods are being rushed ahead of perceived tariff deadlines, while global shipping routes are being redirected to different continents as the anticipated impacts of higher taxes on trade are steadily realised.
- Over the longer term, this is very detrimental to manufacturing, energy and technology sectors, where **political and economic stability are necessary pre-conditions** for major capital expenditure plans, as costs are measured in billions and payoffs are measured in decades.

In this volatile market environment, with a global recession potentially looming, investors are looking far and wide for **shelter in a storm**.

- Indeed, Australia stands up well in terms of **economic resilience**, demonstrated over a long period of history that included the Asian Financial Crisis, the Tech Wreck, the Global Financial Crisis and most recently through the Great Lockdown.
- There are **clear reasons for this resilience**, which we will explore further, but robust population gains, responsiveness to lower interest rates and a flexible exchange rate are all well-tested shock absorbers for the domestic economy in the face of adverse external shocks.

Ultimately, we have seen **fewer and shallower economic downturns** in Australia, which we think is a chronically underappreciated factor behind its historically strong performance over the last 30 years.

Over longer timeframes, we see different degrees of resilience across markets, which affect the frequency, magnitude and duration of cyclical downturns and ultimately long-run economic performance

Downturns in the last 30 years	Number of recessions	Size of downturn	Average duration	Total growth
Australia	2	-4.2%	6 months	3.1% p.a.
New Zealand	8	-2.9%	8 months	2.5% p.a.
United States	4	-3.4%	9 months	2.7% p.a.
Canada	4	-4.9%	8 months	2.3% p.a.
United Kingdom	4	-7.3%	11 months	2.1% p.a.
Japan	8	-2.4%	8 months	1.5% p.a.
South Korea	2	-6.0%	8 months	5.5% p.a.

Source: Bloomberg, National Statistical Agencies, NBER, MaxCap Group (May 2025)

# Fright and flight

Not surprisingly, the unstable global trade outlook is causing **havoc across financial markets**, even ahead of their full impacts on economic activity, both inside and outside of the United States.

- **Share market** volatility is shooting up, while share prices are taking a step down. While all equities are being affected, there is some nuance to this bear market, with relatively sharper dips in the United States and Japan and milder corrections in China, Europe and Australia.
- **Bond market** volatility and yields are also rising. Notably, US Treasury bond yields – the default risk-free asset underpinning the global financial system – have risen. Investors are anticipating a higher degree of US market risk, and adjusting quickly by pivoting into alternative low-risk bond options in Europe and Japan.
- **Exchange rate** markets are moving swiftly as well. In previous cycles, a global downturn typically meant a weaker Australian dollar (AUD). This cycle is looking somewhat different, with the AUD depreciating predictably against many major currencies, but not against the US dollar in this cycle (given increased concerns about the US market).

Altogether, we are seeing **a remarkable adjustment** in global capital markets playing out in real time, as mobile capital flows from markets perceived to have higher levels of risks, towards relatively safer havens.

- Certainly, **Australian capital markets** are not immune to these global capital market shocks. Indeed, we have seen a synchronised correction in share prices, albeit to a relatively smaller extent compared to the US. Moreover, short interest rates are falling in Australia, without the counterproductive uplift in long bond yields.
- At the same time, in a weaker global market environment, some of these adjustments are **playing out to Australia's benefit**, at least on a relative basis. Over time, we expect to see stronger capital inflows into the region, given its well-preserved status as an island of stability, with persistent rule of law and low sovereign and market risks.

Global financial markets have reacted poorly to this trade war. Share prices have dipped, bond risk premia have lifted, while exchange rates have moved in line with the flow of capital out of the United States



Source: Bloomberg, MaxCap Group (May 2025)



# It's all relative

From an economic perspective, there are clear **channels of impact** in the event of a global slowdown, onto the Australian domestic economy.

- In a global trade war, we can map these effects most directly via the **patterns of merchandise trade**, where Australian imports from the US (2024: A\$52 billion, 12% of goods imports) remains larger than Australian exports to the US (2024: A\$24 billion 5% of goods exports).
- Altogether, **the direct effects from US tariffs** on Australian exports are quite limited. Similarly, there is little appetite for Australian tariffs on US exports, which are deemed by local policymakers to be contractionary and inflationary for the Australian economy.
- Meanwhile, there are adverse impacts working through **financial channels**. Falling share prices diminish income and wealth, while eroding consumer and business confidence. Overall, financial impacts are likely to be the bigger drag than trade this cycle.

At the same time, there are **well-honed shock absorbers** that come into play to sustain the domestic economy during a global downturn.

- **Population growth** remains robust. Certainly, we are seeing a natural moderation in migration from its post-pandemic highs. Looking ahead, better economic prospects locally will support inbound migration flows.
- **Interest rates** are falling. Cash rates are likely to fall further over the course of 2025. At the same time, there is no adverse reset expected for Australia's sovereign risk premia because of unpredictable policies.
- The **currency** is set to adjust further. In a slowing global economy, there is typically a softening in the AUD. In this cycle, the shock absorber is diluted by the concurrent weakening in the US dollar.

For these and other reasons, we believe the medium-term **outlook for growth is well supported** in Australia, in sharp contrast to the more bearish downgrades coming through in other parts of the global economy.

Taking into account the potential impacts of this global trade war, we can start to consider the likely economic effects on a medium-term horizon, with some markets to be more harshly impacted



# Seeking shelter

From an investor perspective, we would suggest several **positive actions to take** in the face of a slower, more volatile set of global economies and markets, to seek shelter in a storm and to realise more consistent returns.

From a **regional viewpoint**, we see markets like Australia being more economically resilient. Historically, we have seen this very clearly during past economic cycles. Familiar shock absorbers typically kick in to limit the duration and severity of the local economic downturn.

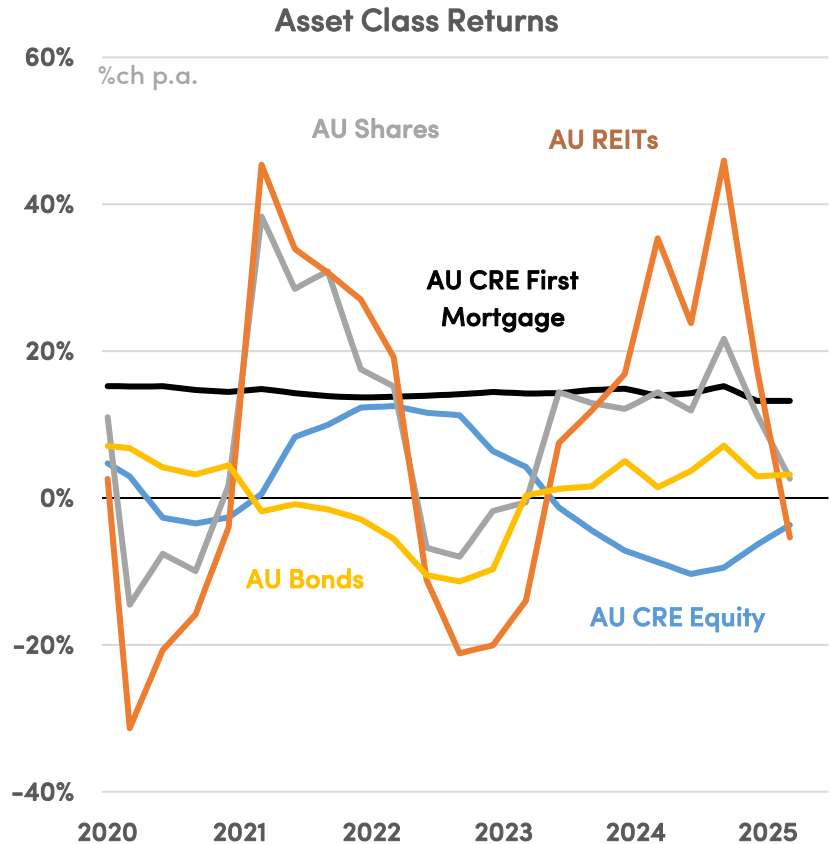
- Most of these **shock absorbers** are at work again this cycle. Australia remains relatively stable and well managed, which should support population growth. Interest rates are falling, which should boost domestic sectors (like consumer spending and housing construction) at a time of weaker export demand. Meanwhile, the currency is depreciating broadly, although less so against the US dollar this time.

From an **asset class viewpoint**, Australian market returns have been adversely affected across many asset classes. Equity returns are impacted by the threat of US and other tariffs. Bond returns are weakening with the increased risks to inflation and sovereign risk ratings. Meanwhile real estate equity returns are still making a slow comeback from the pandemic hits on office and retail occupancy.

- Indeed, the textbook guidance on **portfolio diversification** using stocks and bonds are failing us again in 2025 (as they did recently in 2022). This is reinforcing the ongoing shifts in capital allocations from public to private markets, and from equity to credit asset classes. Investors are moving with more urgency, to seek shelter from the storm and to recover lost diversification benefits.

**In this context, we continue to see sustained resilience in private credit, particularly for commercial real estate debt, where returns continue to hold at a steady pace, despite big historical cycles in economic growth and interest rates.**

The tumultuous global market is adversely impacting on local returns, with clear pullbacks for both shares and bonds. There are not many shelters in this storm, but private credit returns are still resilient.



Source: Bloomberg, MSCI, MaxCap Group (May 2025).  
Past returns are no guarantee of future performance.

# Additional information

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