28 April 2025

March Monthly Report

Dear Investors

We are pleased to provide you with the March 2025 Monthly Report for the Fawkes Capital Fund ("Fund"). In this monthly report, we:

(1) Update our performance for March 2025.
(2) Provide a macro update.

Performance Update:

Global equity markets retreated in March amid rising trade tensions and mounting fears of an economic slowdown. The S&P 500 declined -5.75% over the month, leaving it down -4.59% year-to-date. In March, the Fund generated a modest positive net return of 0.79%. This outcome reflects a deliberate pivot in our portfolio strategy – shifting from a stock-heavy allocation toward a more macro-driven positioning. Although the repositioning unfolded over the course of the month, the benefits have become more apparent in April. Losses from our equity positions were more than offset by gains across our new macro exposures.

Mar-25	1 Mth	3 Mth	1 yr	2 Yrs	3 Yrs	SI (ann)	SI (cum)
Fund (Net)	0.8%	-3.7%	-1.4%	6.3%	3.5%	5.8%	24.5%
Blended Index	-1.6%	-1.1%	3.4%	6.5%	4.6%	5.1%	20.9%
All Ords	-3.5%	-3.3%	2.2%	8.4%	5.2%	6.8%	29.2%
RBA Cash	0.3%	1.0%	4.4%	4.3%	3.6%	2.7%	11.2%

Returns are calculated net of fees and represent the combined income and capital returns over the specified period.
All returns provided are in AUD. Blended Index returns are composed of 50% All Ords / 50% RBA Cash.

As outlined in a recent research note, the portfolio is now anchored by long gold and short US dollar positions. The investment thesis underpinning these allocations has largely played out across March and April. As of the time of writing, we estimate the Fund is modestly positive on a calendar year-to-date basis.

Looking ahead, we expect macroeconomic themes to be a key driver of returns in 2025, particularly given the heightened uncertainty surrounding the economic outlook. As discussed below, we remain open-minded about the range of potential outcomes stemming from the Trump administration's evolving policy mix.

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Macro Update:

We continue to focus on macroeconomic developments, given their broad impact on asset pricing. Our base case remains that a recession is more likely than not within the next year, although we acknowledge this outlook is inherently uncertain, particularly given the potential for rapid shifts in policy settings.

Escalation of U.S. Trade Policy: Liberation Day Tariffs

Liberation Day marked a major escalation in US trade policy, with the administration announcing sweeping reciprocal tariffs on global imports. These measures come on top of earlier sector-specific and fentanyl-related tariffs. In economic terms, a tariff acts as a tax that is shared between foreign exporters and domestic consumers. At current settings, the new tariffs would represent (i) an increase in the average US tariff rate from 2% to approximately 20%, and (ii) the largest effective federal tax rate increase since World War II.

The administration appears mindful that full implementation of these policies could trigger a recession and a sharp correction in equity markets. In response, two key adjustments have been made. First, the full application of reciprocal tariffs – excluding those on China – has been delayed by 90 days, providing the US with additional negotiating leverage. Second, there has been a strategic pivot toward isolating China more specifically.

While we have previously discussed the implications of the tariff delay, this note will focus on the second development.

US-China Rivalry: Strategic and Economic Risks

The shift in US trade policy comes at a time when the United States and China are locked in a broader contest for global leadership. Both nations are competing to shape the international system in their own image, and the trade war has accelerated this strategic rivalry.

The United States is seeking to overhaul the global trading system, which it increasingly views as misaligned with its national interests. By contrast, China, Europe, and key Asian manufacturing nations prefer to maintain the status quo. The outcome of this contest will be a critical determinant of the economic trajectory – and, by extension, asset valuations. If current dynamics were allowed to run their course unchecked, we estimate there is a 90% probability that a recession would follow. However, with trade negotiations ongoing, the most probable outcome is some form of compromise. The nature of this compromise will be pivotal in shaping the direction of the global economy.

The US-China standoff remains particularly intractable – a "Mexican standoff" on a historic scale. With reciprocal tariff levels now exceeding 100%, neither side is willing to make the first move toward de-escalation. China has invoked the saying, "he who ties the bell to the tiger must untie it," suggesting it views the US as responsible for initiating the conflict and therefore responsible for resolving it. Yet a unilateral reduction in tariffs by the US would be seen as an admission of weakness — one that could be seized upon by global media as evidence of China's growing economic power. Politically, such a move would be deeply unpalatable for the administration. As a result, the deadlock persists.

Secretary Bessent has described the current situation as "unsustainable," arguing that a de-escalation must eventually occur. A prolonged trade embargo between the two largest economies in the world is unlikely to endure, he claims. From a free-market, democratic perspective, this appears logical – the economic damage, including lost jobs, declining profits, and wasted capital, would ultimately become politically untenable.

However, this view underestimates China's long-term strategic approach. China plays a different game, with a broader arsenal of policy tools to directly support its economy and absorb short-term shocks.

Trade Negotiations, Loopholes, and Market Exposure

In some ways, today's standoff is even more troubling than the Cold War. Unlike that earlier era, the US and Chinese economies are deeply intertwined – and the economic pain from the conflict is being felt directly on both sides. In addition to US restrictions on Chinese exports, China has recently announced a temporary embargo on rare-earth magnets, critical inputs for future industries such as electric vehicles, renewable energy, and data centres.

Both nations are now racing to reshape global trade alliances. Each is working to either change or preserve the existing system, seeking influence through bilateral and multilateral negotiations. One of the more remarkable aspects of the Trump era is the enduring resilience of his political appeal, despite the extreme nature of the rhetoric and policies pursued. As both sides continue to frame and sell their negotiation efforts to the world, the shape of these compromises will determine not just the economic outlook, but the balance of power for years to come.

There is also a significant difference between high-level memorandums of understanding (MOUs) and fully-fledged, binding trade agreements. MOUs are relatively easy to sign, as they involve limited immediate obligations, while translating them into comprehensive legal texts demands substantial time, expertise, and political will. The key development to watch will be how the Trump administration manages baseline tariff levels as full negotiations unfold.

Even with new agreements, loopholes are likely to emerge. Chinese goods could continue entering the US via third countries with lower tariff rates – a dynamic that already exists. Despite efforts to police it, closing these third-party avenues is extremely difficult in practice. It is neither feasible nor practical to inspect every container or shipment in detail.

The US stock market remains exposed to the risks of a deepening global trade war. More than 40% of S&P 500 revenues are generated overseas, and much of US manufacturers' production is based in Asia. Proposed fines or taxes on Big Tech for their international services exports would further erode earnings if implemented. Absent a major shift in trade policy, we would expect approximately a 10% decline in S&P 500 earnings per share.

Legal Challenges and Implications for Tariffs

There are now also multiple court challenges underway against the Trump administration's use of the International Emergency Economic Powers Act (IEEPA) to impose tariffs. As we have previously discussed, tariffs have never before been applied under this law, and it remains legally questionable whether persistent trade deficits constitute an "unusual and extraordinary threat" under the Act's framework.

Initial decisions from either the California district court or the US Court of International Trade (CIT) could arrive within weeks. However, any final resolution could take considerably longer, given the potential for a protracted appeals process. The administration is actively seeking to shift cases to the CIT, where the likelihood of an injunction halting tariff collections – a risk if cases remain in courts with more liberal judges – is perceived to be lower.

Although it remains difficult to predict how these legal challenges will ultimately be resolved, their consequences for the economy and markets could be significant. Whether through judicial intervention or negotiated settlement, the final level of tariffs that remains in place will likely prove determinative in shaping economic outcomes. We continue to monitor developments closely and adjust our positioning as conditions evolve.

Kind Regards,
Fawkes Capital Management

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