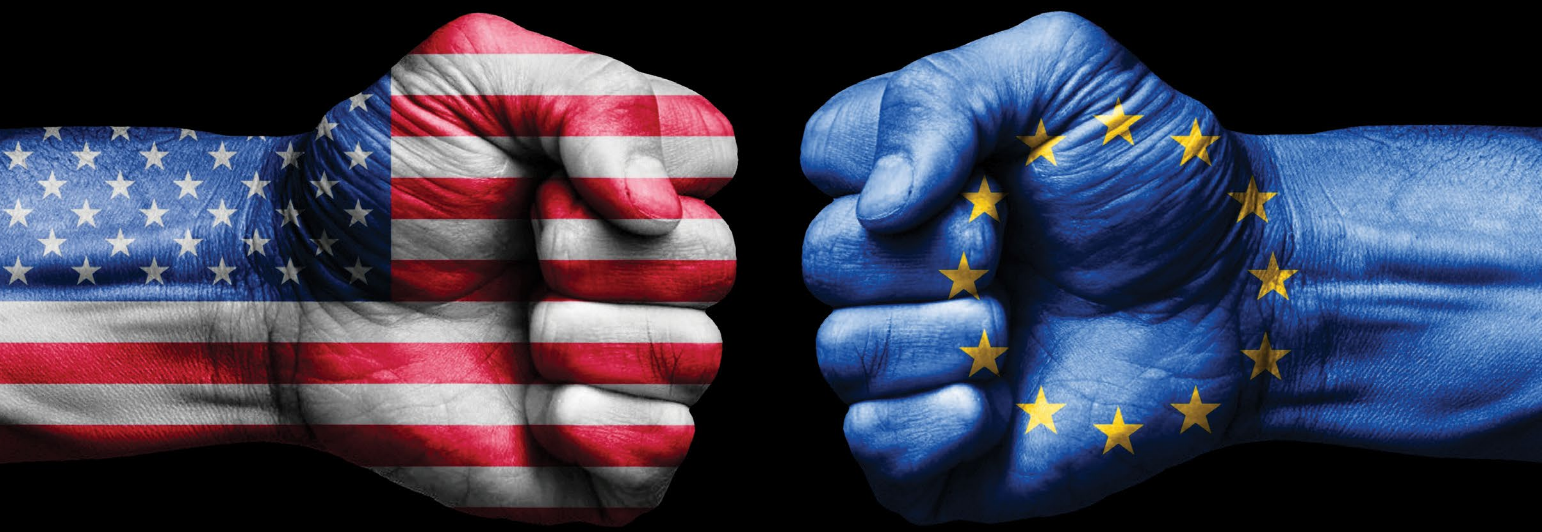

US V EUROPEAN EQUITIES

The gloves are off

Rising trade tensions and aggressive tariff policies from the US are forcing European pension funds to reassess their exposure to American equities. As market dynamics shift, pension fund CIOs are weighing up whether it's time to reduce their reliance on the long-dominant US market or adapt their strategies to navigate the new landscape. Giovanni Legorano **reports**

As uncertainty brews across the Atlantic, European pension funds are reassessing their long-standing reliance on US equities. With the new US administration igniting a volatile trade war, the future of global markets has become increasingly unpredictable.

This sharp turn in transatlantic relations under President Donald Trump – marked by plans to impose steep tariffs on global imports – is sending shockwaves through the world's economies. Economists warn that this aggressive stance could tip multiple countries into recession, drag down global growth, and reignite inflationary pressures.

Currently, the US tariffs announced on the so-called 'Liberation day' on 2 April have been suspended for 90 days, giving room for negotiations between Europe and the US. Initial contacts to negotiate, especially between the US and the European Union, have started.

Despite this, the announcement of the tariffs wreaked havoc on markets, with investors dumping all kinds of investments causing billions of euros in losses.

Shifting strategies

Given also the depreciation of the dollar and the high valuations of US equities compared with their European peers, pension funds are left wondering whether there can be a preferable alternative in European equities.

"We are seeing a shift from when the US had an added premium as a stable and dynamic economy, to added uncertainty and very low visibility on trade policies," Veritas chief investment officer, Laura Wickström, says.

"With this uncertainty, we are experiencing a shift in the equity markets and the vanishing of what was called American excellence, which gave US equities a market premium. Now, it's slightly the opposite."

Due to this high level of uncertainty, Veritas, a Finnish earnings-related pension provider, is in a "wait and see mode" to understand whether the current situation will lead to a recession, she says.

"We made some tactical shifts in our portfolio, because the market has been so volatile and we're regulated investors, so we have to take that into account. But these were more tactical shifts, rather than a real strategic change of directions," she adds.

Wickström also thinks that pension funds may decide to privilege European equities over US equities but cautions that it might be too early to take this direction at the current moment.

"We are preparing for the longer-term investment plan and those are probably the things that we will discuss now. But we haven't made any of those kinds of strategic decisions yet," she says.

A defence mechanism

Coupled with the situation in the US, is the European Union's €800 billion plan to enhance its defence capabilities by allowing member states to take on more debt to buy military equipment and technology and on loans to member states given by the European Commission, the bloc's executive arm.

As a result, many European countries have announced plans to up their military spending.

In addition, the new German Chancellor, Friedrich Merz, has announced plans for a €1 trillion public investment package. Half of this amount will be used to modernise the country's infrastructure, and another sizable part of the package will go to military spending.

These expansive spending plans are poised to drive growth for European defence companies and other sectors, as well as increase the revenue of other sectors, offering pension funds fresh opportunities in European equities.

It has piqued the interest of pension funds. For example, AkademikerPension CIO, Anders Schelde, says: "Because of the actions in the US, you have the fiscal boost in Europe with defence spending.... That, combined with the fact that Europe is simply so undervalued on most metrics, has led us, and I think many other investors, to tactically move from the US to Europe."

Schelde adds that AkademikerPension has already rotated a small part of its equity investments from the US to Europe.

"We have only taken a small position on this, though, because right now we are also making some pretty fundamental changes to our equity strategy, and we do not want too many moving parts at the same time," he adds.

"WITH THIS UNCERTAINTY, WE ARE EXPERIENCING A SHIFT IN THE EQUITY MARKETS AND THE VANISHING OF WHAT WAS CALLED AMERICAN EXCELLENCE, WHICH GAVE US EQUITIES A MARKET PREMIUM. NOW, IT'S SLIGHTLY THE OPPOSITE"

As for the US market, the scheme is yet to conclude on that, but he adds that "it's a long-term issue".

He says: "We used to think that Trump was very sensitive to the performance of the stock market, that there was the implicit 'Trump put' on the market, and thereby also the economy. It appears that it is no longer there, so recession risk has clearly gone up in the US."

While some pension funds are responding now, other pension funds anticipated the market turmoil and shed part of their US equities investments into different assets due to the high concentration of US equities, where the so-called 'magnificent seven' technology companies were largely responsible for the much higher performance of US stocks compared to Europe's.

Indeed, Italian first-pillar healthcare workers' pension fund, Enpam president, Alberto Oliveti, says his scheme moved its equities investments, or around 18 per cent of its €28 billion portfolio, into bonds and cash before the storm in markets materialised. It is now looking at increasing its equity exposure again, but with extreme caution.

"The US equity market is very volatile now, but can also reach some important levels," he says, adding that diversification is key for pension funds.

"Deglobalisation, with the formation of new geoeconomic blocs, is the trend of current times, with growing expectations of inflation and stagnation, coupled with the volatility of reference markets. This is why it is hard to invest with the ordinary approach based on risk, return and duration," says Oliveti, who is also president of the Italian association of first-pillar pension funds, ADEPP. "It will be key to carry out an accurate assessment of adverse scenarios."

More broadly, Mercer CIO EMEA and Asia, Garvan McCarthy, says pension funds are reacting to this unfolding scenario by reviewing exposures, particularly those tied to export-sensitive sectors and dollar-denominated assets.

He agrees with many investors that while it is too early to determine the impact it is important for pension funds to focus on the robustness of portfolios and the ability to withstand market volatility.

"In addition, the importance of stress-testing and scenarios analyses are sharply back in focus for many," he says.

US remains on top

McCarthy cautions, however, that there is currently no evidence of a broader directional flow of capital rebalancing between US and European markets.

"The US continues to dominate the market capitalisation of global equity indices and, as a result, will still attract the majority of investor capital that is allocated on a global market capitalisation basis," he says.

But is there a future where Europe could come out on top? Aon UK head of investment, Maria Johannessen, says that the policies and announcements made by the US administration can, over time, make European equities more attractive than the US' for pension funds.

"I think so, from a broad market exposure, but also specific sectors, like defence, that have been discussed a lot lately," Johannessen says.

"The logic for this is that all companies are going to have to find a way to deal with a landscape of tariffs. Hopefully, there will be a landscape that settles down that's not too penalising," she says.

"WE ARE SEEING A SHIFT FROM WHEN THE US HAD AN ADDED PREMIUM AS A STABLE AND DYNAMIC ECONOMY"

"But then companies have to go back to the drawing board and say, 'ok, how do we optimise around that?' And that gives European countries potentially an advantage."

A potential danger for European companies, however, is that China, which is being slapped with the highest US tariffs, could end up dumping more goods in Europe and put European producers under competitive pressure.

Johannessen believes that while this is a possibility, it's still early days to assess that scenario, because the current negotiations on tariffs could lead to different outcomes. She adds that politically the US 'make America great again' and prioritising buying US goods attitude will generate a response in Europe.

"That should be a net positive for European companies," she says.