



Investment
Perspectives

The clear themes emerging from the tariff chaos

May 2025

A very noisy month

April marked 'liberation month': An attempt by the Trump administration to re-balance global trade back in favour of the US by imposing of a raft of new tariffs on trading partners friend and foe.

The month turned out to be quite chaotic, with the announced reciprocal tariffs postponed (for 90 days) while the US administration supposedly opened negotiations with individual countries. In addition, tariffs on Chinese imports were increased (up to) 145%.

Markets were understandably extremely volatile – and as markets do, goaded some commentators into making varied predictions ranging from a certain US recession, the end of the USD as a reserve currency and fears of a capital flight from the US.

Through all the noise, we believe some important themes are emerging which are likely to last well beyond any potential forthcoming tariff compromise (or non-compromise).

Theme 1 – Real investment is at risk

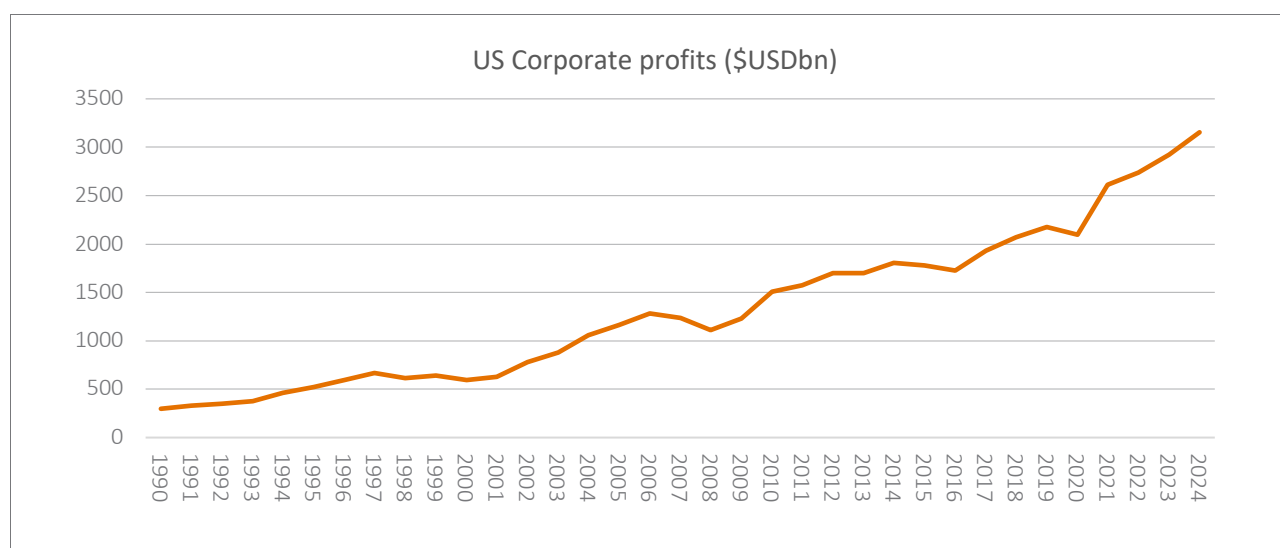
Last month we wrote about the risk of a US recession with the imposition of tariffs. The fact we had to re-write and re-edit the paper three times in the week prior to publishing told us something about the wider economy. The sheer uncertainty of the current environment means long dated investment decisions are now at risk. If companies can no longer be certain of 'rules of the game' we think it will make sense to just sit out of the game and preserve capital until the dust settles.

At this stage, no matter the compromises or announcements made, the hap-hazard manner in which tariff policy has been announced (and withdrawn and announced again) makes the investment world highly uncertain. How long would such a 'grand plan' remain in place given? What (if any) real investments can be made knowing in roughly 3 ½ years there will be a new administration (highlighting the inherent instability associated with policy via executive order).

Lower investment is not just a drag on GDP, but it also has significant implication on Theme 2 below.

Theme 2 – Increased risk around US company profits

Since the COVID recovery of 2021-2022, equity investors have gorged themselves on a steadily rising equity market, driven by a significant acceleration of company profits. According to the BEA, total company profits in the US now exceed USD \$3.1 trillion, an increase of \$1.0 trillion since 2019.



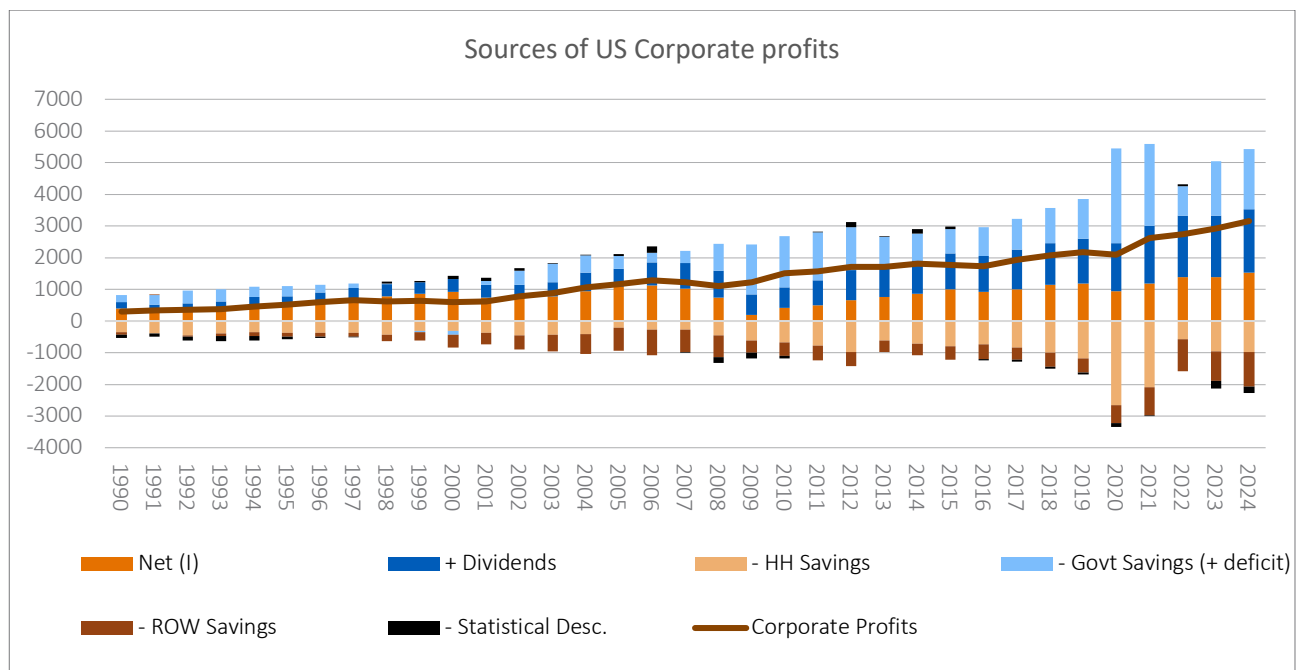
Source: BEA, Quay Global Investors

The profit boom may have come as a surprise to some, especially in the face of rising interest rates. However, by understanding the [Kalecki-Levy profits equation](#), investors would note that company profits are an accounting identity that has very little to do with interest rates. At a macro level, company profits are generally driven by four factors: Investment, government deficits, household savings, and foreign savings.

As a refresher, the accounting identity is highlighted below.

Company profits = national investment + government deficits – household savings – current account deficit + dividends paid

This identity is not just theory – but supported by empirical data as seen by the chart below.



BEA (NIPA Tables 5.1, 4.1, 1.17.5, 1.12), Quay Global Investors

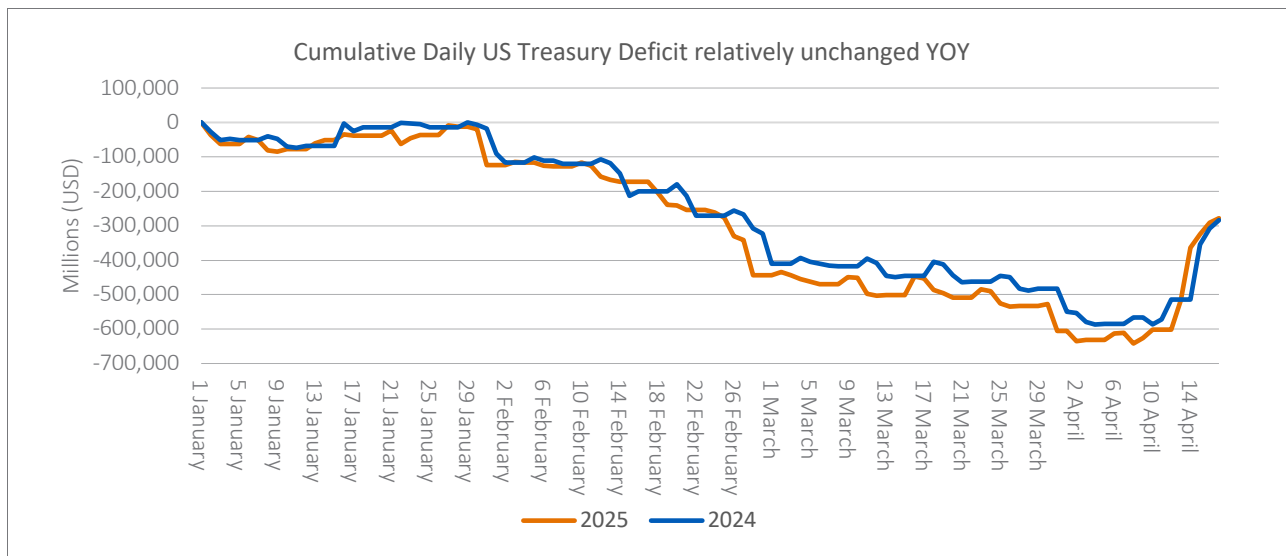
Since 2019, company profits have benefited from:

- a 28% increase in annual investment (\$340bn)
- a 17% decline in annual household savings (\$202bn) and
- a \$650bn increase in annual federal deficits.

These factors alone added +\$1.2T to US company profits since the pandemic.

Past tailwinds are now at risk as the investment environment becomes more uncertain (Theme 1), which in turn may lead to a more cautious consumer (and higher savings).

In the past, headwinds were overcome by expanding US deficits. For example, after the GFC US deficits increased by \$1T – significantly offsetting the 60% or \$0.5T collapse in investment (see chart above). While during COVID, the US deficit expanded to \$2.8T. The concern for company profits today is no such reacceleration of government deficits appear to be forthcoming. To date net government spending is tracking the 2024 run rate – not disastrous, but not adding to growth. More worryingly, the Administration seems determined to *reduce* net government spending, and generating additional revenue via tariffs will certainly help in that regard.



Source: Daily Treasury Statement, Quay Global Investors

These fresh profit headwinds (and lack of fiscal tailwinds) come at a time when profit expectations remain relatively high. At the time of writing, according to FactSet, 2025 US company profit expectations call for:

- earnings growth of 8.2% for Q2
- earnings growth of 10.6% for CY2025 and
- earnings growth of 14.2% for CY2026.

In the absence of any new fiscal impulse (ie: tax cuts), we see the risk to US corporate profit expectations is to the downside.

Theme 3 – New real estate supply is now less likely

While falling net investment is a headwind for the broader economy and company profits, it is a medium-term tailwind for real estate. In short, falling investment means less new supply, and for real estate that is a big deal.

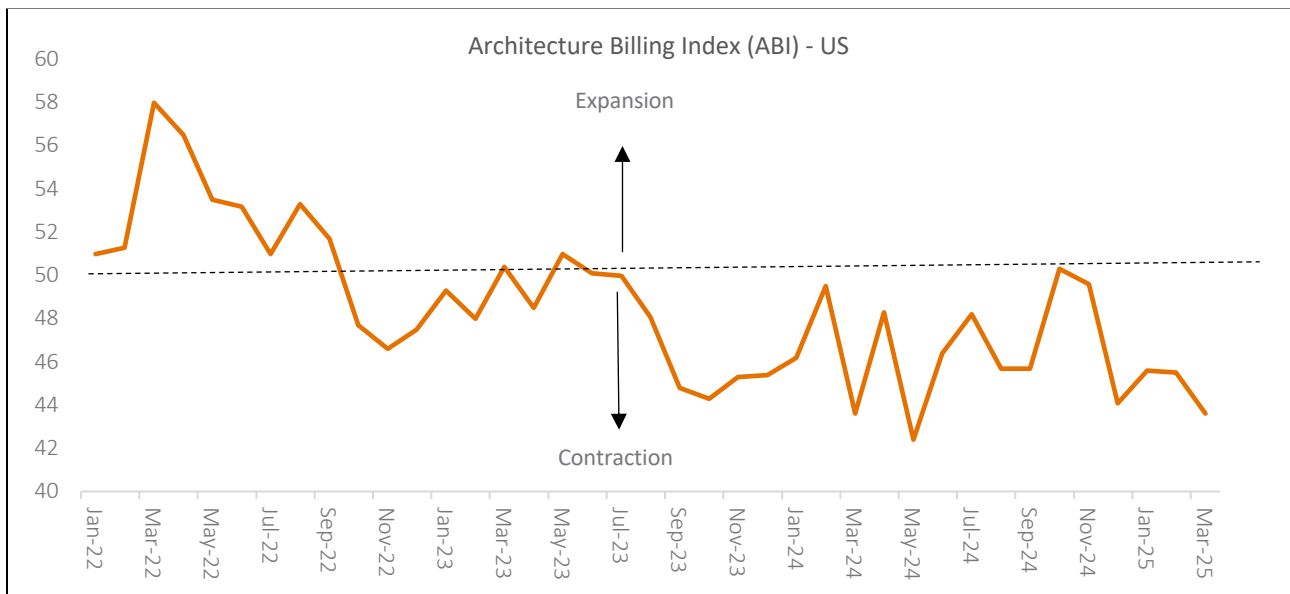
Today, inadequate supply in sectors such as data storage and senior housing has already resulted in double digit revenue and net rental growth. Such rental growth may be a pre-cursor to what will emerge across other sectors as builders and developers 'ice' current projects due to tariff and leasing uncertainty.

Prior to April, we were consistently hearing from company management of our portfolio holdings that new supply is decelerating across multiple real estate sectors including office, multifamily, single family and self-storage.

The signs of lack of supply extends beyond anecdotal feedback. The AIA Architecture Billing Index (ABI) is a leading economic indicator of construction activity. It is produced by the American Institute of Architects (AIA) and reflects the approximate nine-to-twelve month lead time between architecture billings and construction spending¹.

The ABI is based on a monthly survey of architecture firms that asks respondents to rate the level of their billings (or the amount of new design contracts) as either 'increase', 'decrease' or 'no change' from the previous month. An index is compiled, where a score above 50 indicates a net increase in billings, and a score below 50 indicates a decrease in billings. The latest reading (for March) was 43.6, the 14th decline in monthly billings – a situation likely to get worse post 'Liberation Day'.

¹ <https://inside.lighting/lighting-industry-market-info/architecture-billings-index>



Source: The American Institute of Architects (AIA)

The long lead times associated with most commercial real estate sectors means lack of new supply could be a theme which lasts for several years. In sectors where tenant demand remains somewhat stable, rental growth is possible even in a world where US profit growth stalls.

Theme 4 – Tenant demand will weaken but vary greatly across sectors

Real estate is not immune to the headwinds of weaker company profits and weaker GDP. So which sectors are more vulnerable?

In keeping with Theme 1, any sector where leasing reflects an investment – that is, leasing that commits a tenant to several years of obligation (i.e. long lease terms) are probably most at risk.

This includes sectors such as:

- Office
- Retail and
- Industrial.

Separately, the 10% fall in US inbound tourism² will negatively impact hotels and sectors that benefit from tourist spending (such as coastal retail).

Real Estate business models that rely on transactions to generate income (developers, property managers etc) are also at significant risk. If the investment spigot is turned off, transactions will stall, and developer profits can fall substantially while balance sheets become bloated with unsold inventory.

Separately, we expect leasing demand for short duration and needs-based real estate to remain relatively steady, including:

- Senior housing
- Residential
- Self-storage and
- Manufactured housing.

² Source: <https://www.cnbc.com/2025/04/23/international-tourists-domestic-american-travel-abroad.html>

Theme 5 – Don't panic over the bond market

An emerging concern last month was the state of the US bond market. Specifically, that long-dated bond yields rose during significant market drawdowns led many investors to speculate 'something was broken' in the US bond market. Theories included:

- capital flight from the US (no longer seen as a safe haven)
- foreign selling, forcing yields higher
- specific leveraged bets on US bonds unwinding (so called basis trade) and
- bond vigilantes fed-up with ever increasing deficits.

Our message here is simple. As the monopoly issuer of USD, the US Federal Reserve can always be in full control of US interest rates either indirectly (via cash rate and guidance) or directly (yield curve control). Over time, the long end bond yield will ultimately reflect long term interest rate expectations. And those expectations in turn are driven by Fed policy and guidance³.

In the short run, bond yields, like equities, can move on fear creating short term price inefficiencies. We believe care should be taken extrapolating short-term observations into assuming long term structural changes.

For more reading on this topic please refer to our November 2022 paper, [Bond vigilantes don't exist for a monetary sovereign](#).

Concluding thoughts

As most investment managers can attest, making long term investment decisions in the current environment is very challenging. Given the long lead times associated with real investment, this challenging environment is as true in the real economy as the financial one.

And that, in a nutshell, is the theme of 2025.

We believe current policy uncertainty may stall company investment decisions, which in turn will have the following knock-on effects:

1. Act as a headwind for macro company profits.
2. Slow overall economic growth, possibly resulting in households increasing savings.
3. Further diminish an already dwindling pipeline of future real estate supply.
4. Delay some leasing decisions – especially long-term multi-year leases.

We believe these themes are lasting, notwithstanding any near-term resolution on tariff policy since these themes are based on policy uncertainty – and the uncertainty is likely already baked into the cake.

³ An area where the Fed (and other central banks) has less control is the currency. But we will leave that discussion for another day.

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