

## ENDURING INSTABILITY

The Trump administration in the USA has so far responded consistently to signals from the financial markets. However, those markets are undergoing fundamental changes themselves. For investors, it is more important than ever to focus on agility, transparency, and diversification.

“TACO – Trump Always Chickens Out”. That is the latest saying circulating on Wall Street, never short of a punchy phrase. It is a reference to the so-called “chicken game” from game theory, often used to analyse decision-making scenarios. In this model, two cars speed directly toward each other. The one that swerves loses the game. If both swerve, it ends in a draw; if neither does, both die. It is an image that lends itself readily to today’s confrontational politics.

A defining moment, both milestone and symbol of our confrontational present, was the appearance of President Trump in Washington on 2 April 2025, where he announced drastic import tariffs on both allies and rivals, displayed on large placards. The financial markets reacted instantly and sharply: the US S&P 500 fell more than 10 percent in just three days, nearly making it into the top ten steepest equity sell-offs in the USA since World War II. Equally striking was the response in the US Treasury market: yields

on 10-year bonds spiked by over 50 basis points within three days, which is highly unusual for this typically slow-moving segment, and the sharpest such increase since 2001. At the same time, the US dollar, contrary to its reputation as a safe haven in turbulent times, went into a sharp decline.

Evidently, this dramatic market reaction prompted President Trump’s team to partially retreat, suspending the proposed tariffs for 90 days. Following the market rebound, British journalist Robert Armstrong referred to the situation in the Financial Times as the “TACO Trade”, coining the phrase cited above. His point: one could rely on the Trump administration – as in its first term – to back down whenever the financial markets applied enough pressure.

### Anything happened?

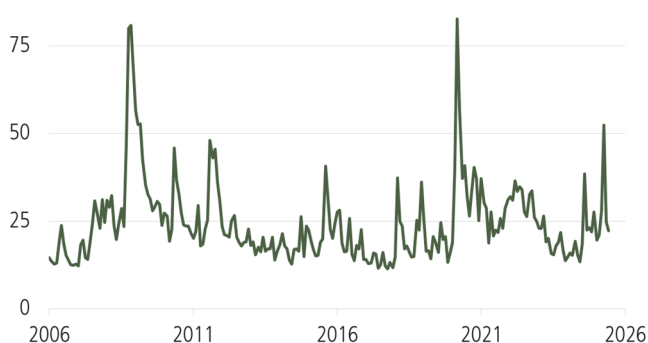
Now, with the 90-day suspension since the so-called “Liberation Day” of 2 April 2025 running out, things have calmed down nearly everywhere. Most major players in the financial markets appear to be counting on “TACO”. Apart from the US dollar, which has lost nearly 10 percent against the euro and Swiss franc since early April, and even a bit more since President Trump’s inauguration, most markets have recovered from the tariff shock, or even risen above their previous levels. Further evidence of stabilisation comes from the Chicago Board Options Exchange Volatility Index (VIX), the most widely



watched “fear gauge” for financial markets. The VIX measures the expected volatility of the S&P 500 over the upcoming 30 days. In early April, as tariffs were announced, the index surged above 50 points, but it has since subsided to near its long-term average of around 20 points. The prevailing signal: “risk-off” (see chart).

US VOLATILITY INDEX, JANUARY 2006 – JUNE 2025

### RISK-OFF



Source: Bloomberg, Chicago Board Options Exchange Volatility Index.

This relative calm in the financial markets appears paradoxical, especially against the geopolitical backdrop. Even setting aside the trade policy challenges triggered by the Trump administration, the world is not exactly short of problems. Most notably, the war in Ukraine continues unabated, and in the Middle East, first Israel, then the USA openly entered into conflict with Iran. A few years ago, such developments would have sent oil prices soaring and shaken markets to their core. But the USA now produces its own oil, and the global economy is more service-based, less dependent on fossil fuels. It almost seems as if the markets have become immune to the constant crisis. “Crisis... what crisis?” people ask. Among younger investors, a meme has been circulating for some time: “Nothing ever happens.” Its message: nothing can stop the markets – every correction is followed by a rebound.

### Rewired

But we should not deceive ourselves. Conditions remain precarious, and the ridge is narrow.

Confrontational politics meets a financial system undergoing rapid change. A number of institutions – including the Swiss National Bank (SNB), the Bank for International Settlements (BIS), and the Financial Stability Board (FSB) – have recently highlighted the growing importance of the non-bank financial sector, which lies outside traditional banking regulation. This heterogeneous group was once referred to as the “shadow banking system”; today, it carries the more refined label of Non-Bank Financial Intermediaries (NBFIs).

Particular attention is being paid to non-banks that engage in bank-like activities, such as lending. These include finance companies, certain types of hedge funds and private debt funds, as well as a variety of money market instruments. According to the FSB’s latest report on the sector, the volume of this so-called “narrow NBFIs” segment doubled between 2013 and 2023 among the 29 most significant global economies, reaching roughly USD 70 trillion – around 15 percent of the entire financial system. More recent figures are not yet available. By comparison, the overall financial sector, including banks, grew by 70 percent between 2013 and 2023, while global GDP rose by just under 37 percent in the same period. In short, financial volumes are growing faster than the real economy, and the role of non-banks is becoming more significant.

In its Financial Stability Report published in mid-June 2025, the SNB noted that non-banks have increasingly been involved in episodes of systemic stress. Notable examples include Archegos in 2021 (family office), the UK’s “gilt crisis” in 2022 (pension funds), Signa (private credit) and Silicon Valley Bank in 2023, where financial intermediaries helped trigger a bank run. There is considerable evidence to suggest that, in the wake of financial innovation and the regulatory overhaul following the 2007–2009 global financial crisis, many banking-style activities have now migrated into the non-bank sector. At the same time, the risk of contagion between banks and non-banks is high especially in times of crisis.

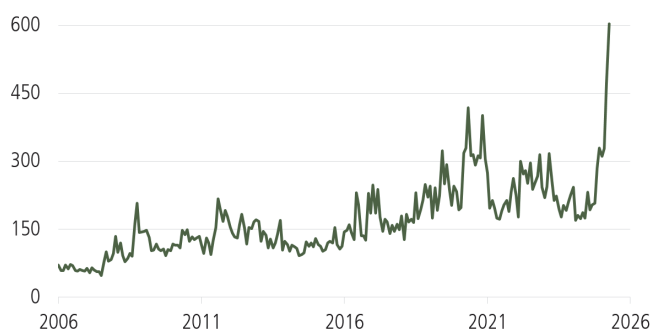
The Economist recently addressed these changes under the headline “New, untested, and



dangerous,” focusing in particular on the USA and the meteoric rise of new financial players such as Apollo, BlackRock, Blackstone, KKR, Citadel, Jane Street, and Millennium. The payments and monetary system may also be on the cusp of transformation, especially since the US Congress recently passed legislation setting out the regulatory framework for the issuance of stablecoins on the blockchain; the so-called “Genius Act”. In sum, large parts of the financial system are being rewired at a time of mounting uncertainty and surging public debt. The Economic Policy Uncertainty Index (see chart) makes this clear: from “Liberation Day” to the “Genius Act” and the “One Big Beautiful Bill”, uncertainty is rising, and with it, the potential for market surprises.

ECONOMIC POLICY UNCERTAINTY INDEX, JAN. 2006-JUN. 2025

## RISK-ON



Source: Bloomberg. The index is based on automated media analysis, measuring perceived economic uncertainty.

Ask seasoned regulators where the next financial crisis is likely to originate, and the answer is: the USA! Still, there is good news: the shifts in the non-bank financial sector are now being closely monitored – the problem has been identified. The bad news: due to America's dominant position, the world is more exposed to US assets than ever before. US Treasuries and the US dollar form the backbone of the global financial system and the tech giants of Silicon Valley are the engine of the world economy. A loss of confidence in either could have catastrophic consequences; the margin for error is slim.

## Agility matters

So the signals are mixed: “risk-off” on one hand, “risk-on” on the other. Can this state of affairs continue? Probably not. But forecasts must be treated with particular caution in the current environment. Analytical and mathematical models rely on historical statistics and trends, and they are failing more frequently than usual. Often, wishful thinking or one’s personal views on what is “right” or “wrong” stand in the way of sound decision-making. That is why, in such environments, scenario planning is widely used, not only as a method for mapping out potential outcomes, but also to confront uncomfortable possibilities and prepare accordingly. A recently published analysis titled “Dealing with America” by Konrad Hummler and Ivan Adamovich applies this technique to today’s realities.

Translating this mindset into the world of investing, scenario thinking begins first and foremost with optimal diversification. But this must be approached with care and extend well beyond asset classes alone. Geographical exposure and the choice of custodian locations are also highly relevant. In an era full of surprises, maintaining one's agility is absolutely crucial. That means ensuring liquidity and marketability, exercising caution with leverage, insisting on maximum transparency for a reliable overview, and maintaining clear ownership structures and simple contractual terms. Only with these elements in place can decisions be made swiftly and with confidence.

Yet despite all necessary caution, one must not lose sight of a core truth: periods of upheaval are rich in opportunity, also with regard to the ongoing rewiring of the financial system. A well-considered investment strategy ultimately requires being invested. No one can predict the best days in the markets in advance — and missing them can mean losing a significant portion of returns. From that perspective, the collective decisions made by financial market participants appear quite rational: perhaps the “TACO trade” is not the worst strategy after all. Still, it would be unwise to bet everything on it.

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IA, 30.06.2025



## HOUSEWORK

At present, there is much quarrelling at the highest levels. Dispute, deception, threats, and outright interventions have taken the place of verbose diplomacy, which had at least one virtue: it accomplished little or nothing. Now, everything seems to be in flux.

What to do? One might, quite naturally, wish for a return to the status quo ante. That is the favoured stance of those for whom the admittedly unconventional new US President is nothing more than a passing phenomenon. "The midterms will take care of it", is their credo. Perhaps. But what if, in a year and a half, Donald Trump gains even more ground? Others place their trust in the American institutions, in the belief that they will ultimately remain inviolate: the Supreme Court, the Federal Reserve, term limits, the (relatively) sovereign states, and the (unfortunately rather vague) security guarantees embedded in the NATO treaty. But what if one or more of these pillars begins to crumble?

The greatest threat to Europe is not Russia, but rather the gentle regulatory monster that is Brussels, with its snouts and tentacles.

I would suggest we prepare for the likelihood that a disruptor will be at work for some time – and if not this one, then another cut from a similar cloth. In other words, it would be wise to assume that the world will look quite different in a year or two than it did in the days of the venerable Joe Biden. In many respects, that transformation is already underway.

Setting aside, in my view, unrealistic wishful thinking, one ought really to seize the moment and bring one's own house into order – preemptively, if necessary. I am speaking above all of Europe. Certainly, threatened import tariffs

can be met with reciprocal measures. But a more intelligent response would be to simply make ourselves more competitive. For example, energy costs in Europe are up to three times higher than in the USA, thanks largely to the aggressively anti-economic energy policies of past German governments. Within the EU, there exist, according to an IMF study, non-tariff trade barriers that rival the very tariff levels President Trump has threatened. A true internal market, therefore, does not exist in the EU. Despite nearly thirty years of a common currency, the European capital market remains fragmented and, by comparison with American conditions, hopelessly illiquid. The euro will never become a reserve currency under these circumstances – even if the Americans are busy sawing away at the branch of the global trading system.

Without a move toward greater competitiveness, all other efforts, especially in the realm of security policy, are likely to prove illusory. In the end, they simply cannot be financed by a demographically declining, economically waning continent. The greatest threat to Europe is not Russia, rather the gentle regulatory monster that is Brussels, with its snouts and tentacles.

But doing one's housework is also wise at the micro level, within one's own family and private finances. In dangerous times, it pays to have raised and educated one's children well, to have regularly assessed the resilience of one's home base, and, where necessary, to have arranged for alternatives. One ought not to have invested all one's money in the bonds of distressed states, but rather, prudently spread across the globe, in shares of companies capable of generating cash flow even under adverse conditions. And last but not least, it helps to have, here and there, a handful of genuine friends.

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KH, 30.06.2025

