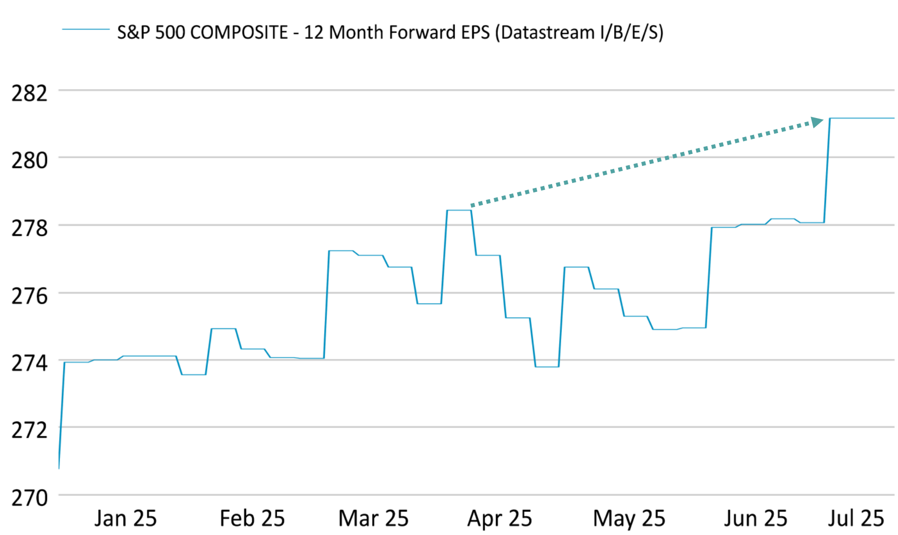
July 2025
Issue No. 36

GLOBAL INSIGHT

Overview

- In our Market Review, we provide an analysis of 2025 to date through a macroeconomic lens, assessing the key trends and underlying forces that contributed to a volatile period in capital markets.
- We look into the unfolding tariff saga, beginning with a shock to expectations on Liberation Day, triggering a market selloff that troughed on Orange Tuesday and precipitated a recovery in risk appetite through quarter end.
- We explore the burgeoning AI theme and, relatedly, the longstanding US exceptionalism narrative, while considering the impact of escalating US fiscal expansion and debt levels on monetary policy effectiveness.
- In our Investment Outlook, we contextualise the key macro developments and market movements highlighted in the Market Review.
- We consider the forecasts for key macro variables and the implications for asset allocation and return prospects.
- We present our house view, noting broad market resilience, while remaining mindful risks to ensure portfolios are well-positioned for both opportunities and potential downsides as the prevailing market regime evolves.·

US Equities—forward earnings expectations—exceeding pre tariff turmoil highs



Source: *LSEG Datastream*

Inside this issue

The Highlights

- Are US Exceptionalism and the A.I. theme set to continue, or are they trades to fade?
- Do escalating US debt levels pose an existential threat to the US Dollar's reserve currency status?
- What are the prospects for inflation and growth—and how might they influence monetary policy?
- With uncertainty around tariffs, where should portfolios be positioned to navigate volatility?

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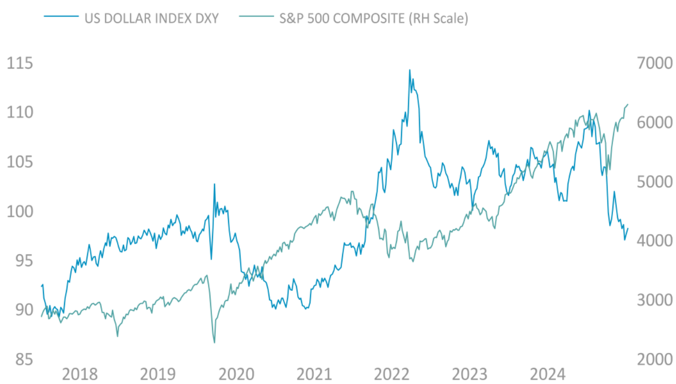
Based upon information available up to and including:

18th July 2025

Key Issues in Charts

USD / S&P500 Index

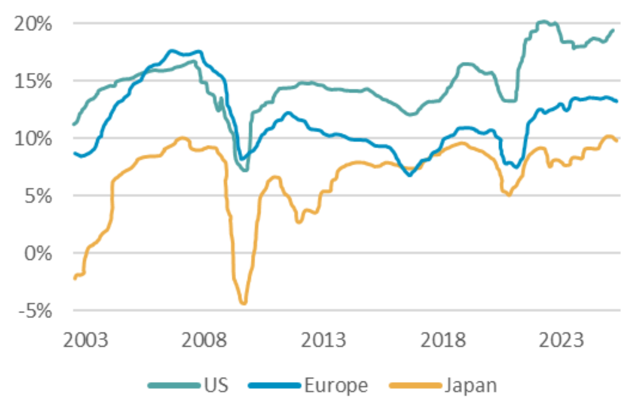


Source: *LSEG DataStream*

- US equities, as proxied by the bellwether S&P500, have staged a staggering recovery since the early-April shock.
- Simultaneously, analyst consensus expectations for index-level earnings per share have regained and surpassed pre-Liberation Day highs.
- The US Dollar, meanwhile, has endured prolonged weakness, facing various headwinds: central bank de-dollarisation, investor hedging, prospects US rate cuts and investor flow away from Dollar-denominated assets.
- The combined results have been meaningfully lower US equity returns for Sterling or Euro denominated investors.

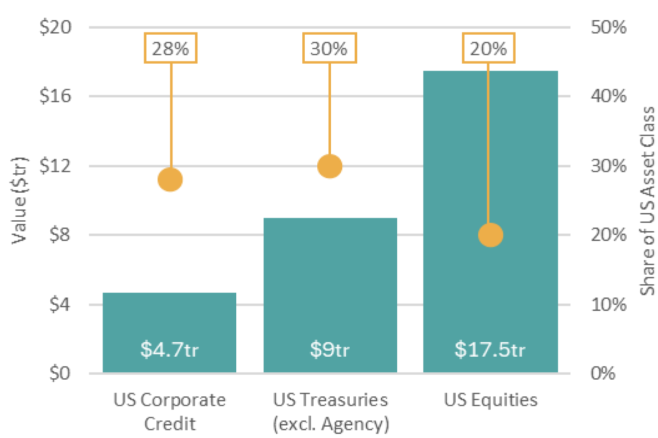
Regional Return on Equity, 2003-2025

- Regional, market-weighted returns on equity—a measure of corporate efficiency—have broadly continued to recover since the COVID-induced deterioration endured in 2020.
- The Japanese measure, while narrowing its differential to the US and Europe as an increasingly-friendly shareholder regime continues to unfold, nevertheless lags developed market peers.
- During the depths of the Global Financial Crisis, the measure for the US and Europe troughed at similar levels in 2009. The US' evolution since has been far more robust, given investment-related legislation and the emergence of technology giants.



Source: *LSEG DataStream. Regions proxied by respective MSCI indices.*

Foreign Holdings of US Assets by Instrument



Source: *Federal Reserve, Invesco*

- According to the US Treasury, the total value of foreign holdings of US assets in the public markets is approximately twice the size of US investor holdings in foreign assets.
- Over the past decade, the percentage of US Treasuries held by foreigners has declined, while remaining broadly stable for US Corporate Credit and US Equities.
- The US' relevance in the financial markets far exceeds its scale in the global economy. While comprising a quarter of global GDP, the country's equities constitute almost half the value of the world's publicly-traded companies.
- Monthly flows into foreign-domiciled US Equity trackers turned negative in 2Q. We remain globally diversified.

Markets Review

As we cross the halfway point of 2025, we reflect on an eventful period in both geopolitics and markets. The first two quarters have seen a bear market for the S&P500, turmoil in the bond markets, and a highly uncertain and incoherent US trade policy that has targeted both friend and foe.

And yet, at the time of writing – an important disclaimer in the currently volatile and highly changeable environment – most major developed market indices are at or near to all-time-highs. Market participants could be forgiven for being a little surprised.

We have witnessed one of the strongest market recoveries since the "V-Shaped" COVID rebound.

Orange Monday

Our last quarterly investment piece centred on the fallout following President Trump's Liberation Day tariff announcements and the ensuing market rout. With markets reaching the nadir on the 8th April, colloquially known as Orange Monday, with contemporary parallels drawn to 1987's Black Friday. Since then, we have witnessed one of the strongest market recoveries since the "V-Shaped" COVID rebound.

When attempting to dissect the recent developments in financial markets, its crucial to understand how expectations have evolved. The outlook and uncertainty surrounding the proposed tariffs remains as unclear now as it did in April.

So, what's changed?

As we wrote on 11th April, in the midst of the crisis, investors were exhibiting behaviours associated with extreme fear: CNN's Fear & Greed index[i] – a gauge of investor sentiment – bottomed at three, indicating extreme fear. It now stands at 76 (out of 100), a reading associated with extreme greed. There has been a meaningful upswing in investors' expectations and consequently, increased appetite for risk assets.

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In our view, investing is an endeavour in human psychology just as much as – if not more – than it is a field of economics & mathematics. If investor expectations are severely depressed, and assets priced accordingly, a negative but less-severe-than-feared development could be interpreted with relief and deliver an attractive investment outcome. By corollary, when assets are priced for perfection, a favourable development may fall short of very elevated expectations and deliver an adverse investment outcome. This in part provides a glimpse into our aversion to certain parts of the US market, such as richly valued and unprofitable companies, over the recent past.

TACO Tuesday

Delving into what has driven this shift in expectations in more detail, there have been two significant developments. Firstly, a softening of the rhetoric from the

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US administration has helped allay fears surrounding the worst-case scenarios associated with tariffs. The initial concerns that President Trump would pursue a blinkered and dogmatic approach to his agenda, irrespective of wider ramifications, now seems unlikely.

Further to this, we have seen the emergence of the "TACO" trade, shorthand for Trump Always Chickens Out, postulating that fierce words from President Trump are brinkmanship: an opening salvo to invite negotiation and, ultimately, pursue a compromise of more market-friendly policies. The emerging mindset that the leader of the free world need not be taken seriously may have longer term implications. For now, investors have welcomed it with relief.

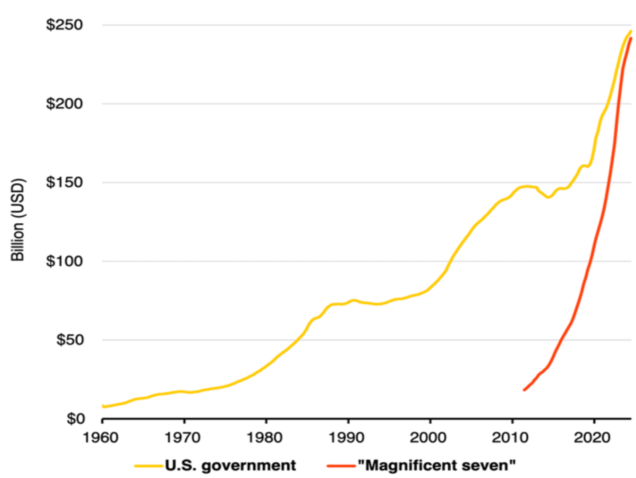
A(I) flash in the pan?

As investors, we are constantly trying to distil the complex interworkings of the financial markets into simple, digestible concepts. This can lead to formation of powerful investment narratives, as expectations and capital coalesce around an idea.

An example in recent history has been the emergence of AI as a long-term structural theme. This has led to eye-watering investments in the AI arms race, and premium valuations – indicating that the market is anticipating higher profits in the future. Whilst there may be question marks over the longer-term monetisation of AI, there is no doubt about the considerable spending in the meantime.

In Q1 alone, Amazon spent $24 Billion on capex – or in other words, just shy of $2 billion a week. As the chart below highlights, spending on research & development since the early 2010s by the "Magnificent 7" – the subset of US mega-cap, technology-focused companies, was on par with the US government since the early 1960s. This represents a monumental barrier to entry for any competitors seeking to challenge their dominance.

Investment Surge, 1960-2024



Source: *BlackRock Investment Institute, with data from Bloomberg, February 2025.*
Note: *The chart shows the investment in research and development from the U.S. government and corporate investment from the "magnificent seven" stocks: Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla.*

US Exceptionalism

For much of the last decade, US financial markets have commanded a premium to all others. Over the past two years, the US economy has demonstrated incredible resilience (more on this later), while the rest of world spluttered.

The combination of exuberance around Trump 2.0, and being home to the previously-touched-upon tech titans, propelled this premium to extremes (by historic standards) coming into 2025. This fuelled a narrative of US exceptionalism, compelling investors to focus on the US and question the merit of alternatives.

Unfortunately, investment markets are fickle creatures, and a narratives' lifespan can be short-lived. More severely, when a narrative falters, the accumulated momentum in assets associated with it can swiftly and violently reverse.

Initially, January saw the arrival of DeepSeek – the Chinese answer to ChatGPT – that delivered comparable results to American counterparts and questioned US technology dominance. President Trump's erratic tariff announcement in April then delivered another blow that cast doubt on the sustainability of US economic growth.

In our view, fears that the US hegemony was ending has played a big part in the volatility we have seen this year. However, true to their name, the aforementioned "Magnificent 7" have resumed their market leadership, delivering a price return of c.19% in the second quarter. Whilst these exceptional – and truly unique – businesses have roared back to all-time highs; investors would do well to remain vigilant to the changing tides of sentiment.

Over the past two years, the US economy has demonstrated incredible resilience, while the rest of world spluttered.

I.O.U

President Trump's Tariff policies have dominated the headlines this quarter, however, the far bigger story may relate to US fiscal policy. The One Big Beautiful Bill Act (OBBBA) sparked an infamous and widely covered spat between Elon Musk and President Trump but has garnered little media attention since.

In short, the OBBBA will extend the 2017 tax cuts from Trump's first term. According to the Committee for a Responsible Federal Budget[ii], the OBBBA will add $2.4tr_to primary deficits over the coming decade and including interest this will add $3.0tr to US federal debt.

Investment markets are fickle creatures, and a narratives' lifespan can be short-lived.

According to Deutsche Bank research[iii], with President Trump's One Big Beautiful Bill now signed into law, the U.S. has effectively locked in deficits of 6.5% to 7% of Gross Domestic Product for the remainder of his administration. Meaning the US Government is going to spend more than it expects to receive in tax revenue, with little flexibility to divert course .

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Market participants have continued to be surprised by the ongoing resilience of the US economy.

Fiscal Dominance

With US debt standing at a towering $36.65 Trillion already[iv], the prospect of another $3tr has caused limited indigestion thus far (although investors have demanded somewhat higher yields from government bonds of various maturities). It is natural that as nations grow, so does the level of debt. The meaningful change now is that the level of debt is now more than 100% of GDP – 124% at the end of 2024, to be precise. With no signs of this abating, the consequences may be serious.

Traditionally, when assessing a policymaker's toolbox, raising or lowering interest rates is the primary lever that can cool or heat the economy. As interest rates rise, private investment is disincentivised, slowing the economy. So, the theory goes at least.

The adage that while history does not repeat, it often rhymes, can sometimes provide a useful steer when navigating investment markets. As such, when central banks globally embarked on one of the fastest and most aggressive rate hiking cycles in history in 2022, many braced for the impending recession.

Market participants – ourselves included – have continued to be surprised by the ongoing resilience of the US economy. Excess COVID savings had been a prevailing theory, amongst other factors. The secret, though, may lie with the treasury and its fiscal largesse.

A New playbook

Over the past few years, an interesting phenomenon has been observed. Rates have risen, and as expected private investment has slowed, but the corresponding rise in government spending has more than offset this decline. Less productive government spending has crowded out more productive private investment. This increased government spending includes elements like the OBBBA and tax cuts. One of the most significant contributors, though, has been interest costs on the burgeoning US debt: for the first time in US history, debt servicing costs surpassed military spending[vi].

This paradigm shift has important implications. Monetary policy is now far less effective at slowing the economy. Whilst this may not seem like an issue, central banks' tireless efforts help to smooth the boom and bust of the economic cycle. Replacing the brakes with another accelerator is unlikely to be effective at cooling an overheating economy.

When a company becomes particularly indebted, the risk that they cannot meet their liabilities rises and insolvency risk looms. In the case of governments, the eventual risk is that they print more money and stoke inflationary pressures more severe than prior experience and current expectations.

This regime change has implications for asset allocation as we seek to navigate future storms. In our view, gold is well placed (and long-term bonds less so) to benefit from these changing dynamics. Gold's finite supply, track record as a geopolitical hedge and, more recently, geostrategic buying by central banks, has underpinned the ancient store of value's success, as it delivered 26% in the first half of the year.

For the first time in US history, debt servicing costs surpassed military spending.

Final thoughts

Monetary policy is now far less effective at slowing the economy.

The current environment of elevated uncertainty brings the possibility of heightened volatility and a broad range of outcomes. Further, markets may be more exposed to the shifting tides of investors' expectations as they navigate uncharted waters. Maintaining a long-term view alongside us, with considered risk management and asset allocation, can offer compelling opportunities to grow wealth over time.

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Gold is well placed to benefit from these changing dynamics.

[i] *Fear and greed index - investor sentiment CNN*. Available at: https://edition.cnn.com/markets/fear-and-greed (Accessed: 18 July 2025).

[ii] Breaking down the one big beautiful bill (2025) Committee for a Responsible Federal Budget. Available at: https://www.crfb.org/blogs/breaking-down-one-big-beautiful-bill (Accessed: 17 July 2025)

[iii] *119th Congress (2025-2026): One big beautiful bill act | congress.gov | library of Congress* (2025) *Market Watch*. Available at: https://www.congress.gov/bill/119th-congress/house-bill/1/text (Accessed: 18 July 2025)

[iv] Treasury, U. s. D.O.T. (2025a) *Debt to the penny*, *U.S. Treasury Fiscal Data*. Available at: https://fiscaldata.treasury.gov/datasets/debt-to-the-penny/debt-to-the-penny (Accessed: 18 July 2025)

[v] World Bank (2025) *US GDP*, *United States GDP*. Available at: https://tradingeconomics.com/united-states/gdp (Accessed: 18 July 2025).

[vi] Committee for a Responsible Federal Budget (2024) *Interest costs just surpassed defense and Medicare*, *Committee for a Responsible Federal Budget*. Available at: https://www.crfb.org/blogs/interest-costs-just-surpassed-defense-and-medicare (Accessed: 18 July 2025)

Investment Outlook

Economic activity has been positive but remains below trend, inflation has moderated but remained stubbornly above target, and monetary policy, despite recent rate cutting actions, remains moderately tight.

These trends are set to continue in 2025.

The US, although forecast to grow less this year than last, is expected to outpace other developed markets.

Compared to last quarter, 2025 growth estimates for the US and Japan declined, while those for the UK and the Eurozone improved.

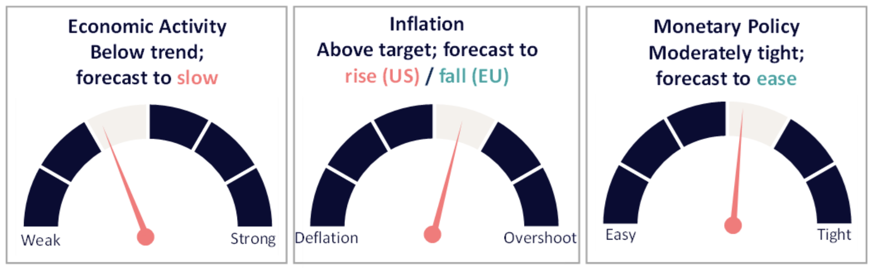
Tariffs enacted at the time of writing amount to a near 20% tax on US consumers, a level not seen in almost a century.

The OECD has reduced its 2025 and 2026 global growth projections.

The probability of a global recession ticked up over the quarter, but remains below historical warning levels.

Having reviewed the key macro developments and market movements during the prior quarter, this section will focus on forward-looking estimates for, and the interplay between, key macro variables: growth, inflation and monetary policy. The schematic below reflects that: economic activity has been positive but remains below trend, inflation has moderated but remained stubbornly above target (although there are regional divergences, more on which later), and monetary policy, despite recent rate-cutting actions and expectations for further easing, remains moderately tight.

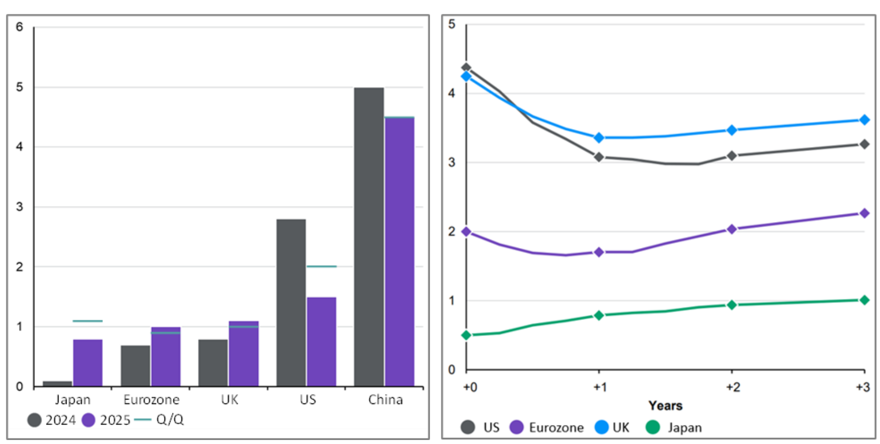
Current Growth, Inflation, and Monetary Policy



Source: *Hottinger & Co. Limited*

The chart below, left, reflects actual 2024 and forecast 2025 consensus expectations for annual GDP growth across major economic regions as at the end of the second quarter. The 2025 q/q estimates continue to expect the US to contract y/y, but to lead the developed world. The teal dashes reflect the prior quarter's estimates for growth in 2025: expectations for Japan and the US have notably declined. In the US, The Budget Lab, a Yale University think tank, has estimated that tariffs enacted through 11th July constitute a c.18% rate for US consumers, the highest since 1933, contributing to a -0.8% contraction in US 2025 real GDP. Globally, the OECD has reduced growth projections for 2025 and 2026 from 3.1% and 3.0%, respectively, to 2.9% for both periods. Separately, MacroMicro's World Recession Probability Indicator stands at c.38% (up 11% from 27% at the beginning of the quarter, but still benign, with persistent readings north of 50% being historically indicative of a likely recession). While these estimates are inherently approximations, their trajectory has proved instructive in the past.

Consensus Forecast for GDP (L) and Monetary Policy (R)



Source: *JP Morgan Asset Management*[i]

Turning to inflation, US Core PCE is the Federal Reserve's preferred inflation measure. It's most recent print, 2.3% y/y in May, continues to defy the 2% target, and the market-implied one-year inflation expectation (being the difference in yields between conventional and inflation-linked treasury bonds) is 2.4%, suggesting limited progress towards target in the near term. Soft (survey) data is more pessimistic, with the University of Michigan's Consumer Survey expecting inflation of 5% in a year's time. Separately, more progress has been made in the Eurozone, where the one-year market-implied rate is 2%, in line with the latest print of the ECB's preferred measure, the Harmonised Index of Consumer Prices, and consistent with its medium-term target.

Official US inflation prints and market-implied expectations continue to defy the Fed's target, while survey data is more pessimistic.

In the Eurozone, current and implied inflation have converged on the ECB's medium term target.

The above forecasts for regional growth and inflation influence respective central banks' monetary policy and future interest rate paths (above, right). While the Federal Reserve has a dual mandate of full employment (growth-related) and price stability (inflation-related), markets are pricing in significant rate easing in the medium term, with three to five 25bps cuts anticipated over the next 12 months, despite persistently above-target inflation, implying that slowing growth is of paramount concern currently: the Federal Reserve Bank of New York's US recession forecast model suggests a c.30% chance of a recession in the next 12 months; this reading is moderately down on the quarter.

For the Federal Reserve, expected rate cuts suggest that growth concerns are paramount.

Meanwhile, over the next year, consensus calls for four rate cuts in the UK, a single rate hike in Japan (battling burgeoning inflation) and little further easing in the Eurozone, constrained by extensive recent fiscal stimulus but with the benefit of policy headroom, given benign inflation (in part due to a strengthening Euro, whose growing purchasing power effectively importing disinflation).

Elsewhere, further easing is expected in the UK, moderate easing in the Eurozone— constrained by extensive fiscal stimulus— and tightening in Japan.

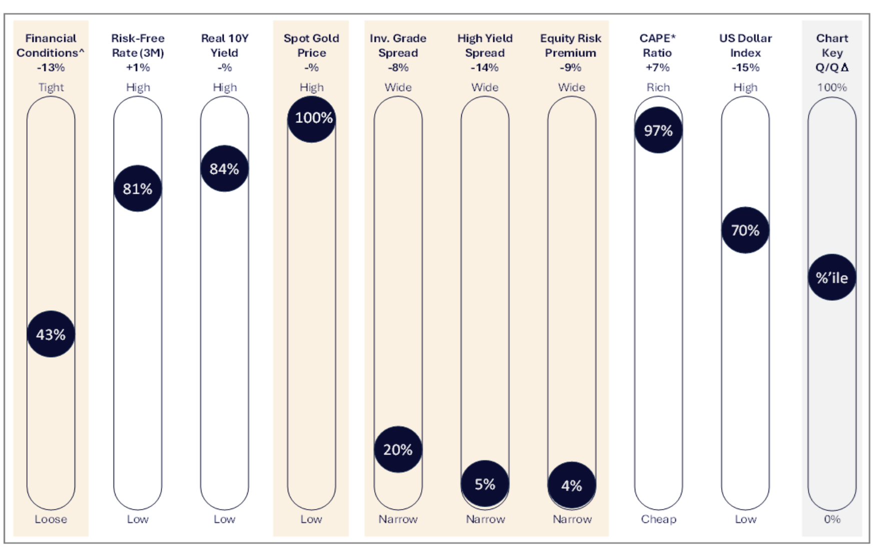
More broadly with respect to financial conditions (chart below), the Federal Reserve Bank of St. Louis' published measure, which incorporates 105 indicators of risk, credit and leverage, eased significantly over the quarter, loosening from the 56th percentile to the 43rd percentile (on a range of 0%, being loose, and 100%, being tight, relative to the past 20 years). This evolution, combined with a stable rate environment (with the risk-free rate's and 10-year yield's percentile readings barely changing over the quarter) underpinned a further rerating of risky asset classes: credit spreads declined, alongside the equity risk premium, as investors bid valuations up and by implication demanded less compensation for taking on incremental risk. Gold's performance was robust.

Financial conditions, adjusted for growth and inflation, eased over the quarter, and rates remained broadly stable.

Against this backdrop, most asset classes performed strongly, with spreads and risk premia declining.

Elsewhere, despite the prevailing 'risk on' environment, gold's performance was robust.

Macro and Markets Barometer



Source: *St. Louis Fed, Chicago Fed, LSEG Datastream, Robert Shiller via Yale Department of Economics. *Cyclically-Adjusted Price-to-Earnings. ^Adjusted for growth and inflation.*

The equity rally has been supported by fundamentals, with earnings revisions broadly improving.

For the US, one year forward earnings expectations have surpassed pre-tariff-turmoil levels.

Almost three quarters of global equity indices have positive forward earnings growth expectations.

The Dollar has been beset by a variety of headwinds, not least the US' deteriorating fiscal position in the wake of the Big Beautiful Bill's passing.

Consensus expects moderate further Dollar weakness, although the currency remains globally dominant.

In summary, global markets have exhibited strength amidst policy uncertainty and related disruption.

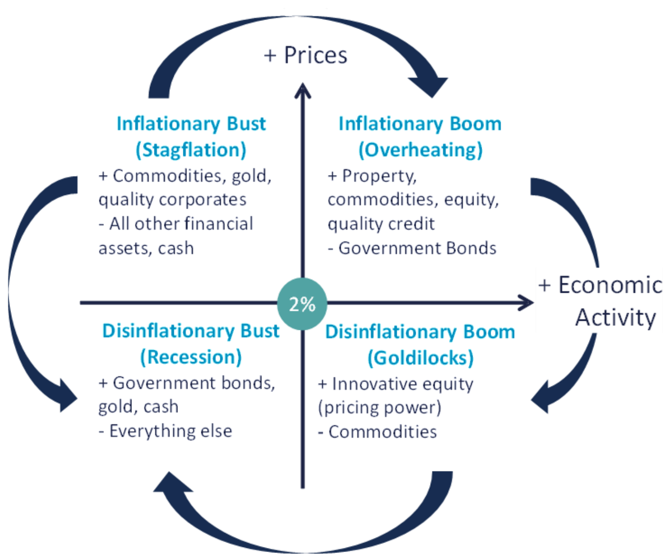
We continue to monitor evolving growth and inflation expectations, and the implications of these in terms of economic regime, positioning accordingly.

This 'risk on' mindset, which took hold in mid-April, following a fortnight's bout of tariff-anxiety-induced 'risk off' behaviour, coincided with a trough and recovery in earnings revisions (i.e. the number of upgrades exceeded the number of downgrades, and the net measure as a proportion of total analyst changes, inflected and rose). Indeed, bottom-up consensus one year forward earnings per share for the S&P500 stand at $281 per share at the time of writing, marginally ahead of the same measure's reading just prior to the slew of tariffs announced by the Trump Administration on 2nd April. Further, MacroMicro estimates that 74% of global stock market indices have positive one year forecast earnings growth (vs. 70% at the end of Q1 and 66% a year ago)[ii]

The most significant Q/Q move in the previous page's chart was in the trade-weighted dollar, from the 85th to the 70th percentile and weakening by c.3% over the quarter, affected by a combination of: central banks reducing their dollar exposure, investors hedging USD-denominated assets, anticipated Federal Reserve rate cuts and the US' deteriorating fiscal position, exacerbated by the passing of the Big Beautiful Bill, which the Yale Budget Lab estimates will add $3tr to US debt over the next decade, assuming that temporary provisions expire, or $3.7tr if they do not (which would add more than 1% to US debt-to-GDP). Consensus forecasts for the trade-weighted Dollar call for more near-term weakness (-7% by year end) ahead of a subsequent partial recovery (-4% a year hence). We maintain global currency diversification and reiterate the Dollar's global relevance, constituting 60% of foreign exchange reserves, almost two thirds of international debt and almost 90% of all foreign exchange transactions.

In summary, then, global markets have been characterised by robustness and resilience, with market participants constructive amidst elevated but declining policy uncertainty and disrupted but evolving supply chains. We continue to monitor evolving growth and inflation expectations, conscious of the potential for a stagflationary regime: below trend economic growth coupled with above trend inflation. The asset allocation implications of such a regime, and other combinations of growth and inflation, are reflected in the chart below.

Asset Class Prospects under Different Economic Scenarios



Source: *Apollo*[iii]*, stylised.*

With economic activity below trend and forecast to slow, and inflation above trend and forecast to diverge but remain above respective central bank targets, we consider the top half of the above schematic as the status quo.

Forecasts for inflation and economic activity suggest that a stagflationary scenario may manifest.

Although we have added to risk assets (i.e. credit and equities in aggregate) during the quarter, we remain moderately underweight relative to our benchmark, given the potential for stagflation to affect both equities and bonds (in aggregate; quality subcomponents less so).

We have prioritised quality, diversification and active management to navigate the road ahead.

We continue to prioritise broad diversification (across currencies, regions and sectors), favour quality and focus on active management. We have maintained healthy exposures to traditionally defensive assets: (1) cash, (2) government bonds, deliberately skewing towards shorter-dated issues to limit sensitivity to interest rates (duration) and to mitigate vulnerability to inflation in an 'overheating' scenario, and (3) gold (to which we added during the quarter, and which has further hedging credentials vis a vis both fiat currency - 'paper money', whose purchasing power erodes over time - and trade policy uncertainty).

We also retain exposure to traditionally defensive assets: sovereign debt and gold.

[i] J.P. Morgan Asset Management _ Guide to the Markets _ UK Q3 2025 _ June 30, 2025

[ii] MacroMicro website. [Online.] Accessed 14th July 2025. Available from: https://en.macromicro.me/charts/119839/world-of-countries-with-positive-yoy-eps-growth

[iii] Torsten Slok et al _ Mid-Year Outlook: At the Crossroads of Stagflation – What's Next? _ June 2025

Important Information

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