BROOKS MACDONALD

THE Quarterly Edit

2025 Outlook
& review of Q2 2025

Q2 2025

Quarter
IN REVIEW


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Investors are no doubt glad to see the back of Q2. Trade wars, actual wars, and a US President apparently threatening then retracting to fire the Chair of the US Federal Reserve, the world's most important central bank, are not ingredients for a constructive investment backdrop.

Nonetheless, global equity indices appeared to navigate Q2 end-to-end reflecting relatively contained impact from these headwinds, but that belies huge volatility investors endured during the quarter. Q2 got off to a difficult start as US reciprocal trade tariffs announced early April sent equity markets into a tailspin. Yet a succession of temporary tariff roll-backs and tariff pauses followed, helping sentiment and markets recover.

Tariff nerves were never far away though, and the end of Q2 brought the prospect of unilateral US tariffs on countries unable or unwilling to agree to a trade deal in time.

In our latest 'Quarterly Edit', we touch on six themes that we hope provide you with an overview that reflects our informed decision-making and helps you understand the complexities of the market.

Our focus continues to be on keeping a balanced and diversified approach, aiming to position our asset allocation choices to weather economic uncertainties effectively, and focused on a long-term investment strategy that is adaptable yet grounded in sound principles. We are grateful for the trust you place in us and are committed to targeting the highest level of service and performance. Together, we look forward to navigating the market's complexities and working towards achieving your financial goals.

When will Trump's trade tariffs impact show up in the economic data?

While tariff on-then-off-again news flow whipsawed investors during Q2, any impact on broader economic data has thankfully so far been largely absent. However, the eventual tariff impact on businesses and households may just be a question of when, rather than if. Companies for example are likely to run-down pre-tariff inventories first before they are either forced to pass on higher prices to consumers or take the cost on themselves hitting profit margins. Later this year, there is a risk that we could see the increased trade friction weigh on both inflation and economic growth, reinforcing our relatively more cautious outlook.

Tariff pauses are temporary not permanent, risking renewed volatility ahead

Welcome economic and market relief from tariff pauses during Q2 is only temporary – tariffs have been paused but not cancelled. Unless more trade deals (like the UK-US deal inked in May and the US-China trade framework agreed in June) are signed-off in time, trade volatility could return when a 90-day tariff-pause for many countries ends on 9 July. Complicating the investment picture, given the risk of renewed tariff angst, businesses might look to repeat front-loading of purchases as they did prior to the original 2 April tariff shock - while that might give a temporary boost to economic activity in the short-term, it does not make the longer-term outlook any clearer unfortunately.

A tug-of-war for inflation pressures leaves clouded outlook for interest rates

Inflation signals presented mixed messages during Q2. While the UK saw renewed price pressures during the quarter, the US saw becalmed inflation data - even though fears remained that there might yet be a resurgence given US President Trump's tax-cut bill proposal risked buoying government deficit spending. Clouding the outlook, oil prices swung during the quarter – while OPEC+ members (the Organization of the Petroleum Exporting Countries plus certain countries including Russia) continued to unwind post-COVID pandemic supply curbs thereby easing prices, an Israel-Iran conflict briefly pressured oil prices higher, before markets correctly assessed fighting had deliberately avoided oil production sites.

Megacap technology seeks to play the AI ‘long-game’

Q2 saw technology stocks get a boost on hopes that longer-term capital expenditure ambitions remain intact. June saw news that Meta (the parent company of Facebook) entered into a 20-year deal with US nuclear operator, Constellation Energy (which operates the largest fleet of nuclear plants in the US), to supply energy for AI (Artificial Intelligence) infrastructure going forwards. The news followed a similar 20-year energy supply deal that Microsoft signed in September last year. This indication of future energy planning from megacap technology companies is likely to boost investor confidence that the broader AI build-out is not a short-term phenomenon.

Banking deregulation offers a tailwind for risk assets

June saw the appointment of US President Trump’s pick for a new US Federal Reserve (Fed) banking supervision chief, Michelle Bowman. A Fed governor since 2018, Bowman is expected to relax banks’ capital buffer requirements and offer a more sympathetic regulatory view towards banks’ merger-and-acquisition activity.

It could spur bank deregulation globally if financial regulators in other jurisdictions around the world come under pressure to avoid disadvantaging their own home-grown bank champions. While deregulation could weaken banks’ counter-cyclical resilience in weathering economic downturns, near-term it is likely to boost banks’ lending growth and offer a tailwind for risk-assets more broadly.

Geopolitics remains an unwelcome headwind for investors

Events during Q2 reminded investors that geopolitical risks remain with conflict, both actual and the threat of such, challenging the investment outlook. While ongoing fighting between Russia and Ukraine continued to thwart hopes for a ceasefire, a new conflict between Israel and Iran led to a US strike on Iran, before a ceasefire was agreed late June. Elsewhere during the quarter, China continued to assert its territorial claim over Taiwan, with increased military drills in the region – it was enough to prompt US Defence Secretary Pete Hegseth to warn “the threat China poses is real, and it could be imminent”.

2025 OUTLOOK

There is an uneasy calmness in markets currently.

Despite early April market volatility induced by US President Trump's reciprocal trade tariffs, it is impressive that the global equity market (as measured by the MSCI All Country World Index in US dollars) clawed its way back to all-time highs during June – although an important caveat is that this fresh record high has in part come about given US currency weakness so far this year – in sterling terms, the record set earlier this year is still yet to be reached.

With sentiment recovering on the back of 90-day pauses in higher tariff rates, those tariff pauses, which end for many countries on 9 July, have arguably proved the decisive factor in limiting for now the impact on the broader global economic picture.

The risk, however, is that any eventual tariff impact could be just a matter of timing, and therefore more of a question of when and not if. The additional trade frictions created by on-off US tariff uncertainty, and its impact on global economic growth and inflation will take time to show up in economic data which is by definition backward-looking and a lagging indicator. Clouding the outlook, in addition there remains elevated risks and lack of clarity around global fiscal, monetary, and geopolitical policy.

After the recovery in markets, we would advise a degree of caution, hence our decision during Q2 to move our global equity guidance down to neutral relative to our strategic equity asset allocation ranges. Within equities, our allocations are spread across regions and countries, delivering diversification across investment styles. For bonds, balancing the risks we take elsewhere, we prefer higher quality and shorter maturity debt that offer relatively attractive yields while limiting sensitivity to unexpected macroeconomic volatility. For our alternative investments, including structured return products, these can offer expected returns and yields that do not always move in the same direction as stocks and bonds, potentially reducing overall risk and balancing portfolios.

Overall, our diversified approach aims to position portfolios to effectively navigate the economic uncertainties that lie ahead.

UK

UNITED KINGDOM EQUITIES

The UK equity market index earns about three-quarters of its revenues from outside the UK, making it sensitive to global trends. UK equities are a key part of our investment strategy, including shares of companies in 'value' sectors such as resources and financials; these stocks might be considered undervalued on a price to earnings ratio or dividend yield basis, for example. These sectors can help balance our growth investments in other regions and asset classes.

US

UNITED STATES EQUITIES

The latest round of US corporate results reflected a still-resilient consumer and supported by a healthy job market on balance. However, to caveat, such data is backward looking and precedes President Trump's tariff uncertainty triggered early April. More interest rate cuts are expected later this year with the US Federal Reserve judging tariff inflation risks as "transitory". In all, US tariff policies have introduced unwelcome uncertainty for an equity market which is relatively highly valued.

EU

DEVELOPED EUROPE EQUITIES (EXCLUDING THE UK)

Continental European equities held onto strong year-to-date performance in Q2, catalysed by increased government spending plans agreed in Q1 and led by the region's largest economy, Germany. However, while Germany has the debt-to-GDP (Gross Domestic Product) ratio headroom to allow for an increase in fiscal spending, the same cannot be said of some other major European countries. Meanwhile, there are still significant headwinds for the region, including US tariff risks and increased Chinese export competition.

AP

ASIA PACIFIC EQUITIES (EXCLUDING JAPAN)

The region's dominant economy, China, continued to face significant economic headwinds in Q2. Structural imbalances, including a heavily indebted property sector, high youth unemployment, and febrile consumer sentiment will take time to resolve. While China's policy makers continued promised support for the economy, lifting share prices earlier this year, the country is still at risk of being stuck in a deflationary spiral, while a degree of lingering uncertainty around US-China trade presents challenges for export growth and business sentiment.

JP

JAPAN EQUITIES

In recent years the Tokyo Stock Exchange has been working to help companies manage their finances better. Along with the return of inflation after years of stagnation, this has improved the outlook for Japan's financial markets and shareholder return expectations. However, Japan still faces headwinds - high public debt levels and an ageing population in particular make it challenging for the Bank of Japan to pull away from its long-standing low interest rate monetary policy.

EM

EMERGING MARKETS EQUITIES

China is a major buyer of global commodities from emerging markets. However, despite promises of increased government spending, China's leaders appear reluctant to rely heavily on their tried-and-tested past model of aggressive infrastructure expansion. Those risks dampen the export hopes of emerging markets more broadly. Additionally, emerging market countries with debt in US dollars are particularly sensitive to US dollar exchange rate volatility and at times this can challenge global investment flows into emerging markets.

Outlooks defined: *We express positive, neutral, and negative outlooks across a range of asset classes. These are defined as our judgement as to the expected return compared to the relevant broader asset class benchmark over our central forecast period of twelve months.*

POSITIVE **NEUTRAL** **NEGATIVE**

Important information

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The views in The Quarterly Edit are correct as at 30 June 2025. All information is current at the time of issue and, to the best of our knowledge, accurate.

More information about the Brooks Macdonald Group can be found at
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