QUARTERLY INVESTMENT OUTLOOK

JULY 2025

STONEHAGE FLEMING

NOW AND FOR FUTURE GENERATIONS

EXECUTIVE SUMMARY

- **The reshaping of global trade relations remains a key market driver:** President Trump has since pivoted towards negotiation, reducing the associated economic costs, and markets have responded positively

- **Further tariff escalation will be met with economic, political and market resistance:** the trade war has a 'self-stabilising' mechanism which should keep long term investors engaged

- **We maintain a positive but measured outlook for global equities:** the growth headwind from higher tariffs and policy uncertainty is likely to be offset by US dollar weakness and the prospect of lower interest rates

- **Our outlook for US assets remains constructive:** while some of the key US tailwinds are fading, such as Magnificent 7[1] dominance and fiscal stimulus, we outline the key strengths of US assets that will endure

- **The era of market concentration is ending, as the Magnificent 7 companies face new challenges:** this is good news for global investors actively seeking broad opportunities

- **The Artificial Intelligence theme is considered a key long term driver of growth across industries**: our emphasis is on how AI is being applied to enhance products and efficiency across sectors

[1] The Magnificent 7 companies include Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla.

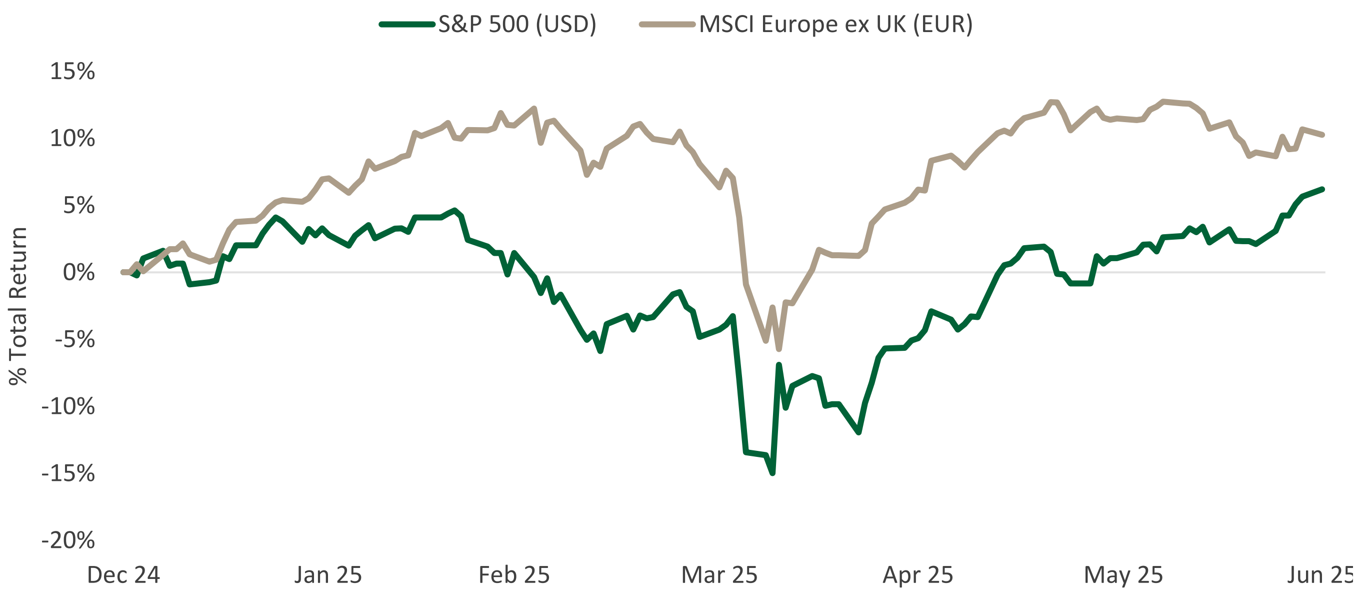
INTRODUCTION

The reshaping of global trade relations has been the dominant market driver in recent months. After imposing unexpectedly severe tariffs in early April, President Trump has since pivoted towards negotiation and de-escalation, reducing the associated economic costs. As we noted in our April Outlook, "*given the multiple constraints facing the administration, a reprieve in trade hostilities can restore expectations for US economic and corporate health from extremely low levels*."

As of early July, final US tariffs on trading partners remain unclear, yet it is our strong view that further escalation will be met with economic, political and market resistance, resulting in an ultimate de-escalation. The trade war has a 'self-stabilising' mechanism which should keep long term investors engaged.

Risk assets appear to agree, staging a strong recovery following the sharp decline in the wake of 'Liberation Day'. Global equities have returned 10.0% in the first half of 2025[2]. Relative to other regions, the US market has regained momentum. In the second quarter, the S&P 500 returned 10.9% in USD, compared to 3.7% for the MSCI Europe ex UK index in Euros (chart 1[3]). Mega-cap US tech stocks, which led earlier declines, have found their footing once again. However, the US dollar remains under pressure, with erratic policy signals, softer growth expectations, and fiscal concerns prompting investors to diversify away from dollar-denominated assets. Such US Dollar weakness has weighed on returns for global investors.

Chart 1: US companies have rebounded strongly



Nevertheless, US importers will still face an effective tariff burden of 10–15%, a notable increase from six months ago. With signs of the labour market softening, the buffers that have supported consumer spending over recent years continue to erode. So far, the impact on consumers and businesses has been limited, supported by pre-emptive inventory building ahead of tariff implementation.

Despite these pressures, the likelihood of a US recession remains low. Corporate fundamentals are strong, with Q1 earnings growing by 12.8% year-on-year[4]. Many firms are actively managing cost pressures through supply chain optimisation and onshoring, helping to contain the inflationary impact of tariffs. This is particularly important, as inflation remains the primary channel through which consumer demand could be undermined.

[2] *Source: Bloomberg, USD, June 2025.*
[3] *Source: Bloomberg, S&P 500 in USD and MSCI Europe ex UK in EUR, June 2025.*
[4] *Source: FactSet Earnings Insight, 27 June 2025.*

Geopolitical tensions remain a key risk, particularly with recent developments in the Middle East, where concerns around potential energy market disruption have resurfaced. However, the US remains reluctant to engage in large-scale military operations or pursue regime change, which limits the likelihood of a major escalation disrupting the current market cycle.

> We maintain a positive but measured outlook for global equities, as the growth headwind from higher tariffs and policy uncertainty is likely to be offset by US dollar weakness and the prospect of lower interest rates.

In this July Investment Outlook, we explore some of today's central market themes in depth, focusing on the outlook for the US dollar and equity markets following a prolonged period of 'exceptionalism' but weaker returns this year.

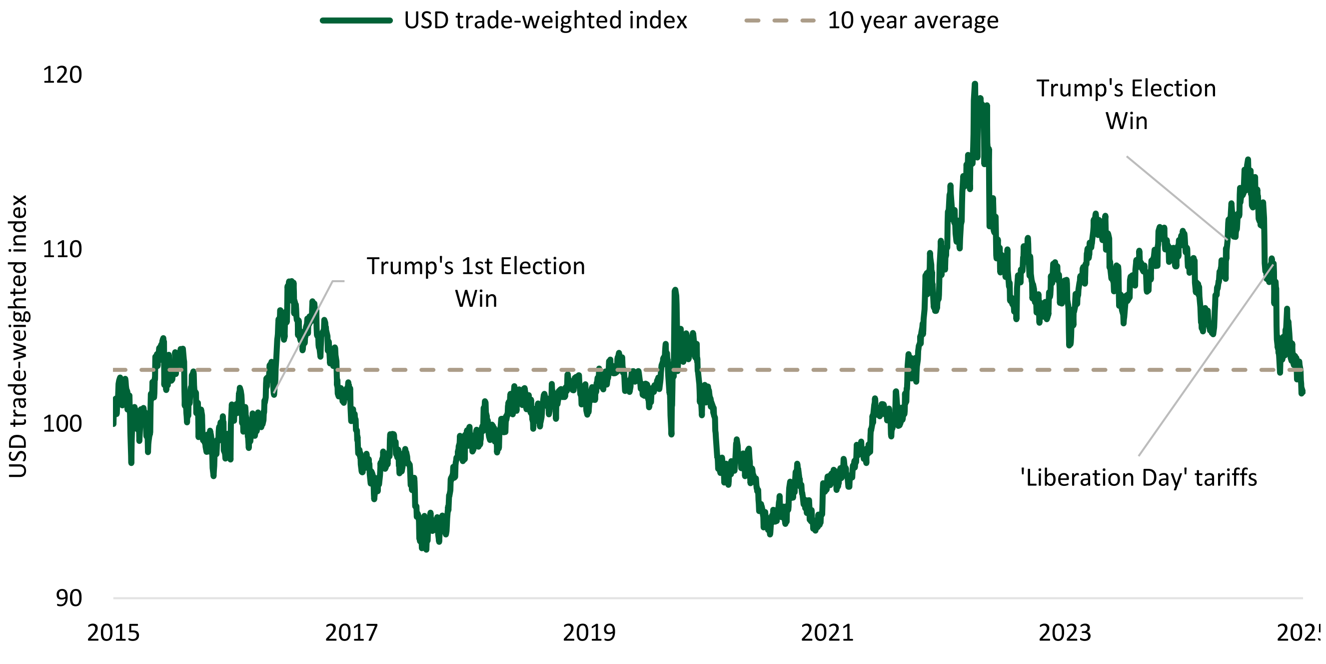
Section 1. The Evolution of US Market Leadership: Resilience and Risk

US Dollar weakness is not unusual

The US dollar has depreciated by 10.7% in the first half of 2025, more than reversing the 7.7% appreciation recorded in the final quarter of 2024. It now trades broadly in line with its ten-year average (see Chart 2[5]). This year's weakness, while notable, is not historically unprecedented.

Indeed, similar patterns were observed in previous cycles. During the early phase of President Trump's first term, the dollar rallied by 8.0% in the final two months of 2016, only to decline by 14.1% over the course of 2017–18. Comparable episodes of weakness occurred in the latter half of 2020 and again in 2022–23, before renewed support for the greenback emerged.

Chart 2: The Trump dollar rollercoaster



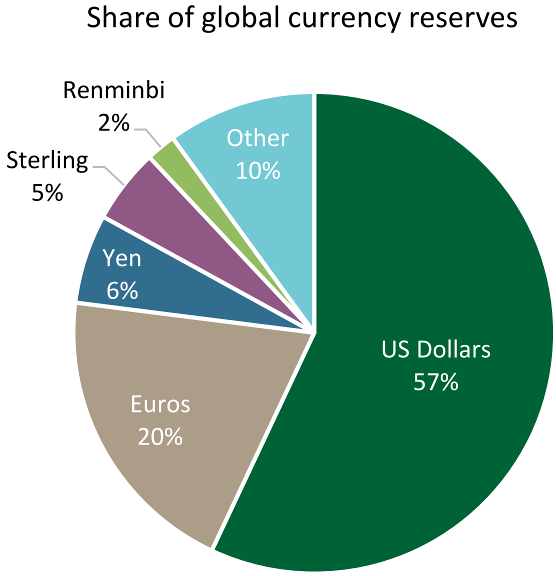
The key question for global investors is whether the current bout of dollar weakness marks the beginning of a structural shift away from US assets and a sustained erosion in value, following years of relative strength. Some argue that the dollar's role as the world's reserve currency is increasingly under scrutiny, challenged by erratic policy direction and a deteriorating fiscal position under the current administration.

[5] *Source: Bloomberg June 2025.*

Dollar dominance will not evaporate anytime soon

It is worth restating the characteristics of the US Dollar as the bedrock of global business. For decades the greenback has dominated, accounting for c. 75% of globally invoiced transactions and c. 50% of international trade by recent measures. Its no surprise that global central banks retain the majority of their reserves in US Dollars (chart 3[6]), with deeper liquidity, higher demand and lower transaction costs than other currencies.

Chart 3: The Dollar Dominates Global Reserves



> The case for a lasting decline in the US dollar is weakened by the lack of strong alternatives. For any currency to challenge the dollar's dominance, it must offer comparable scale, liquidity, and institutional strength.

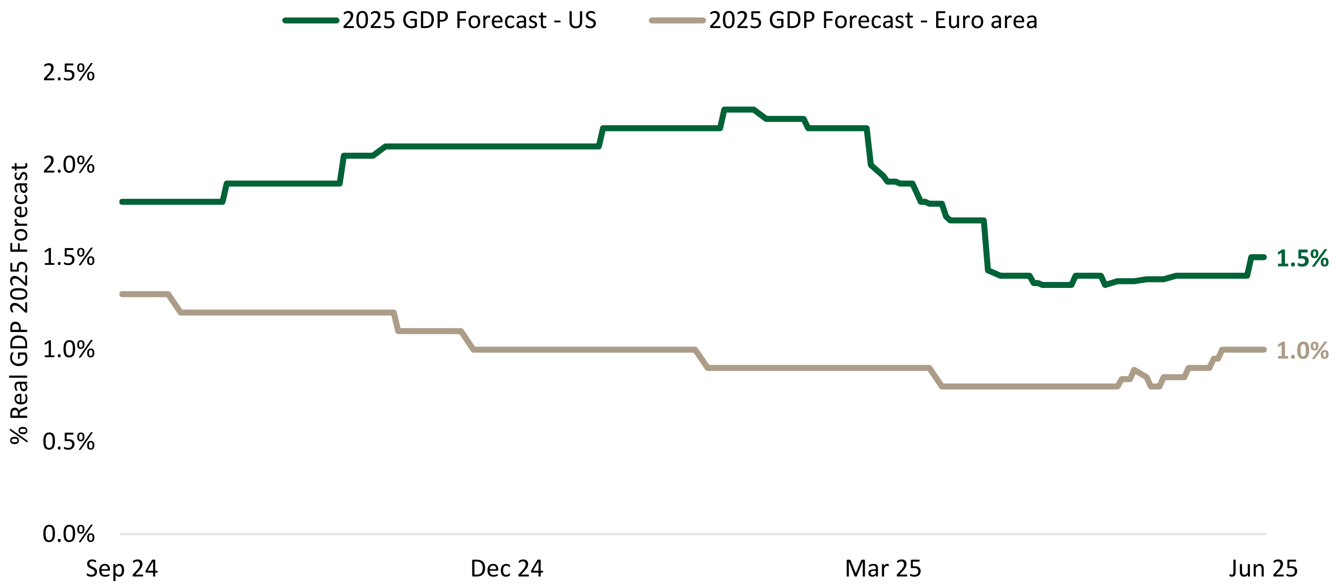
The euro, despite 25 years of existence, still only accounts for c. 23% of global payment transactions. Its progress has stalled due to fragmented markets and limited fiscal unity. The renminbi's global role also remains small. As of early 2025, it accounts for just 2.9% of international payments, ranking sixth worldwide. Efforts to internationalise the currency have been constrained by capital controls and limited convertibility. Ultimately, the US Dollar's status as the world's global reserve currency is not under threat in the near term.

Global growth expectations have rebalanced

The primary driver of the US dollar's weakness this year has been the narrowing gap in growth expectations between the US and the rest of the world. At the start of the year, US economic growth for 2025 was projected at 2.0–2.5%, while Europe's outlook languished below 1%. Today, both regions are expected to grow at a more modest 1.0-1.5% (chart 4[7]).

[6] *Source: Reuters, IMF, March 2025.*
[7] *Source: Bloomberg Consensus, June 2025.*

Chart 4: Converging growth expectations have driven dollar weakness



This shift reflects a reassessment of the post-election economic outlook: initial optimism for a surge in US growth under President Trump has faded, as his agenda has leaned more toward protectionism and geopolitical restructuring than broad-based economic stimulus that characterised his first term. Meanwhile, Europe's outlook has improved, driven by a policy pivot under newly elected German Chancellor Friedrich Merz, who has championed fiscal expansion and pro-growth initiatives, particularly in defence.

> While growth expectations have broadly converged, the case for further US downgrades without similar or larger revisions in Europe appears limited. US growth is moderating as tariff-related headwinds begin to take effect, but given their export exposure to the US, other economies are likely to follow.

In this environment, US assets continue to offer key defensive characteristics—supported not only by market depth and earnings resilience, but also by a favourable real interest rate differential, which enhances their relative appeal during periods of slower growth and heightened uncertainty.

Trump's signature fiscal package: The One Big Boring Bill?

As President Trump's signature fiscal bill, the 'One Big Beautiful Bill Act (OBBBA)', passes through Congress, investor concerns are mounting over the rapid growth of US government debt. The federal shortfall currently stands between 6–7% of GDP, and some market participants worry that a failure to consolidate could unsettle bond markets and undermine confidence in the US dollar.

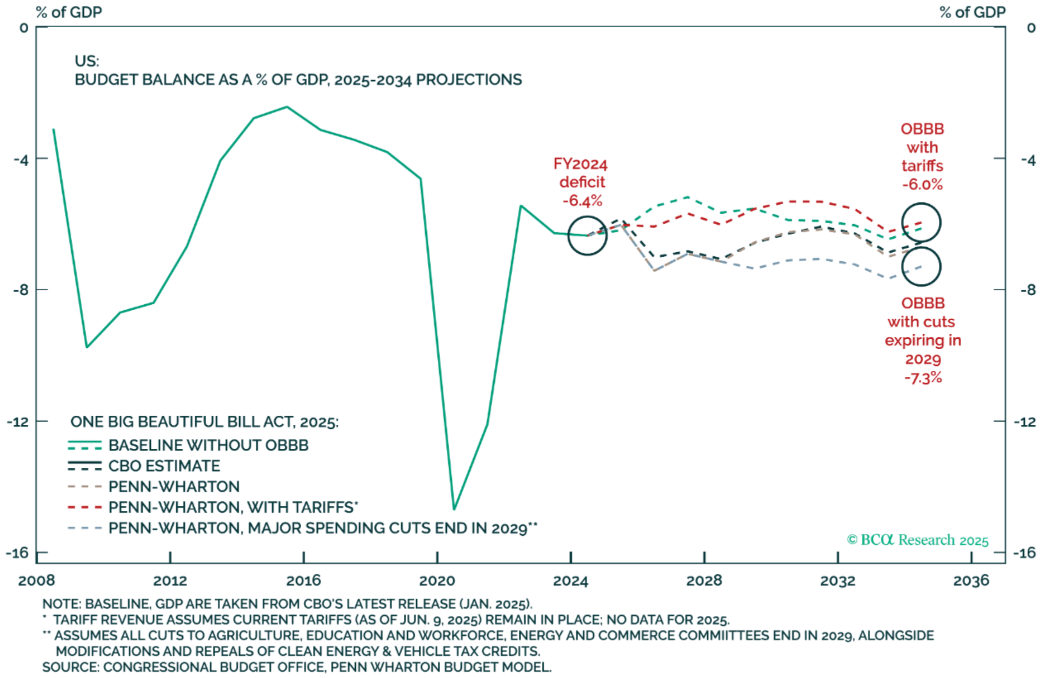
A closer examination of the fiscal implications of Trump's presidency offers some near-term reassurance. In fact, the scale of projected deficit expansion suggests a notable moderation to prior years. For context, the American Rescue Plan Act of 2021 injected $1.9 trillion into the economy in a single year alone. President Trump's 2024 campaign proposals totalled a potential fiscal expansion of up to $10.5 trillion over a decade by some measures.

In fact, President Trump's flagship fiscal plan is considerably more restrained. Current estimates project an increase in the federal deficit of $2.4 to $3.8 trillion over the next decade, largely driven by the extension of tax cuts enacted during his first term. Importantly, proposed tariff revenues could offset up to half of this cost, potentially reducing the fiscal deficit rather than extending (chart 5[8]).

> The One Big Beautiful Bill Act reflects a more measured approach to fiscal policy than is widely acknowledged, marking a significant shift away from the expansive spending seen in recent years.

[8] *Source: BCA Geopolitical Research, June 2025.*

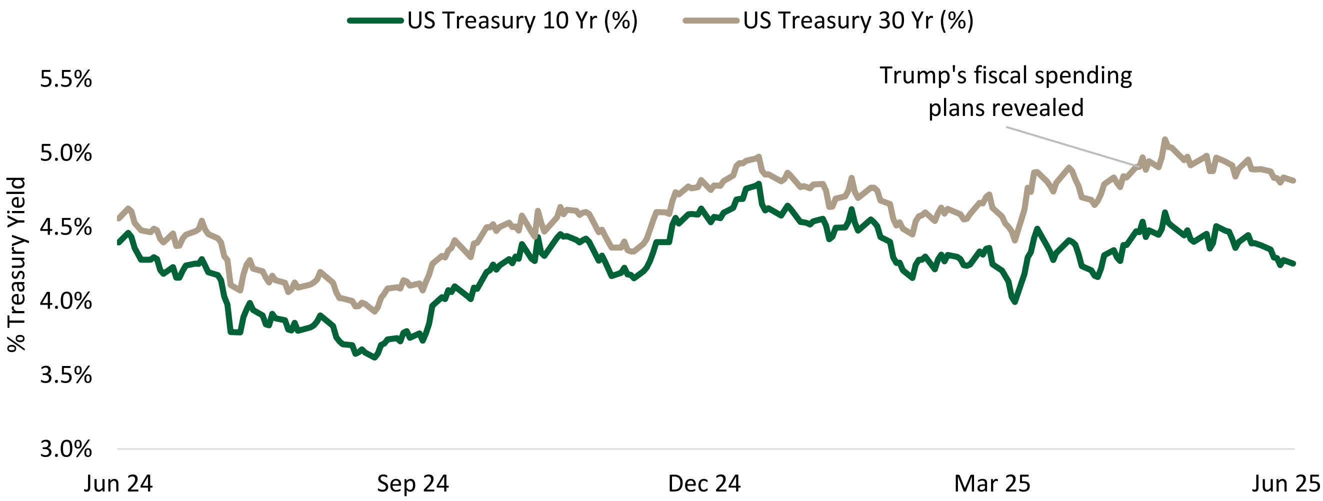
Chart 5: The fiscal deficit is not spiralling out of control



A review of the recent paths of the US 10 and 30 year Treasury yields provides valuable context. As illustrated in chart 6[9] below, the bond market serves as a critical check on fiscal policy.

Notably, since President Trump unveiled the details of his flagship spending plan, long-term bond yields have declined—an indication that global investors may be signalling approval of the policy direction.

Chart 6: Treasury Yields Have Stabilised



This analysis carries several implications for the US dollar. In the near term, fears of a 'Liz Truss moment'—where unchecked fiscal expansion triggers a collapse in the dollar and a surge in bond yields—appear overstated. The current fiscal package is more restrained and is being financed at higher yields than in recent cycles, reducing the risk of a disorderly market reaction. This is not the precursor to a dollar crisis that some investors have feared.

The longer-term outlook is less certain. Fiscal stimulus has been a key driver of US growth in the post-pandemic period, and with that impulse now fading, the structural drivers of dollar strength may become less pronounced.

[9] *Source: Bloomberg, June 2025.*

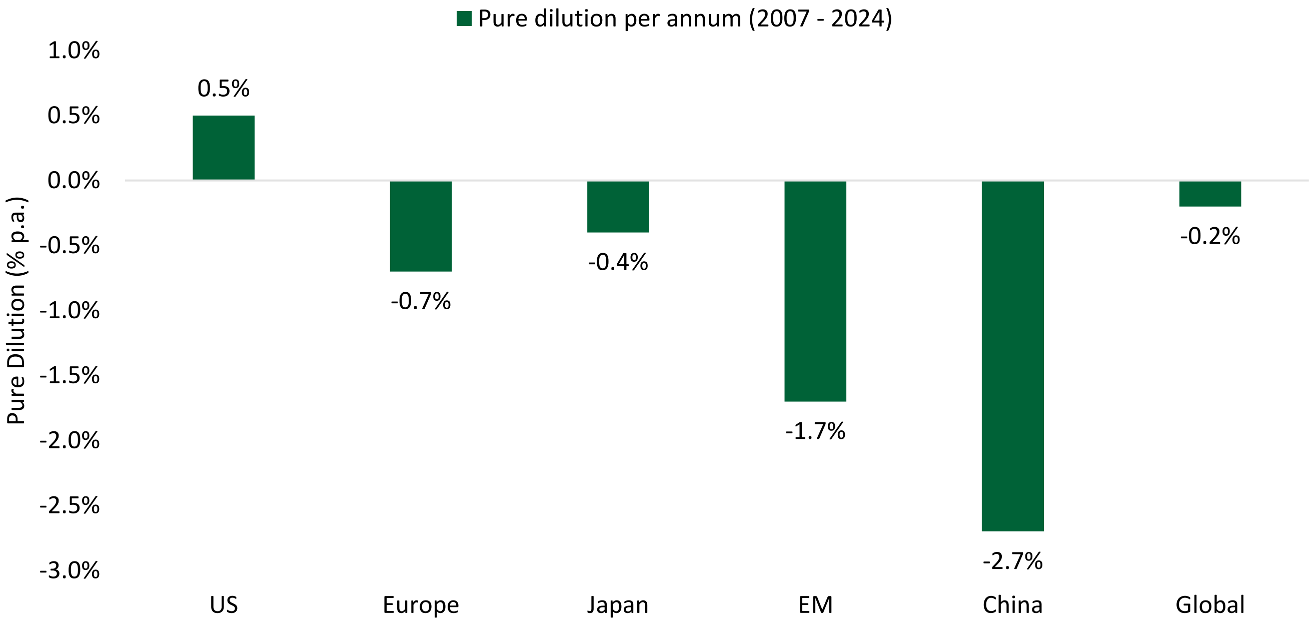
US equity exceptionalism is not binary – many strengths remain

In line with the US dollar's role as the world's reserve currency, US equities have significantly outperformed their European and Asian counterparts over the past 15 years. To assess whether this trend can continue, we consider which structural drivers remain intact and which may be at risk.

> Two key factors have consistently underpinned US market leadership since the Global Financial Crisis: a shareholder-friendly corporate culture and superior productivity. There is little evidence these characteristics have diminished.

US companies have demonstrated a persistent commitment to shareholder returns, particularly through large-scale share buybacks, which have supported equity prices and reduced net dilution. In contrast, equity capital in Europe and emerging markets has often faced less favourable treatment. Recent analysis on net dilution across regional indices from Arthur Budaghyan, Chief EM Strategist at BCA Global Research, quantifies this impact. This analysis focuses on 'pure dilution', which incorporates changes in company shares outstanding and adjustments to the indices over time. As shown in chart 7[10], compounded annual net buybacks of 0.5% per annum over the past 18 years have supported superior US market returns, compared to persistent and deep dilution elsewhere, particularly emerging markets.

Chart 7: Positive dilution gives US equities a structural edge



The US also enjoys a structural productivity advantage, supported by more flexible labour markets, deeper capital pools, and a stronger innovation ecosystem. By comparison, Europe's more rigid labour regulations, fragmented financial systems, and lower R&D intensity have constrained productivity gains. These differences have translated into higher returns on capital and stronger earnings growth for US companies over time, reinforcing their long-term market outperformance.

[10] *Source: BCA Emerging Markets Research, June 2025.*

The Magnificent 7 companies face new challenges

One of the key drivers behind the US market's multi-year outperformance - its dominance in mega-cap technology - is now facing a more uncertain outlook. The Magnificent 7, who are integral in AI, cloud, digital platforms and advanced hardware sectors, represent approximately one third of the S&P 500 index, up from approximately 12% ten years ago[11]. Over this period these companies have delivered an impressive c. 38% per annum return, compared to c. 10.4% per annum for the S&P 500 equally weighted[12].

After a decade of remarkable growth leading up to the pandemic, driven by scale, innovation, and industry disruption, the Magnificent 7 saw their performance further accelerated by the AI boom. Nvidia, in particular, has become a central player in the US market, with its share price rising nearly 800% over the past five years as demand surged for its GPUs, which are essential to powering advanced AI models.

While these firms continue to hold significant competitive advantages and leadership across key technology sectors, the landscape is shifting. The emergence of challengers like Chinese AI start-up Deep Seek, whose open-source model launched in January is dramatically cheaper than US alternatives, underscores the rising global competition and the growing pressure on US incumbents to sustain their dominance.

> A particular challenge is the evolution of major US tech firms from businesses defined by low capital intensity and rapid profitability growth, fuelled by powerful network effects, to a high capital expenditure and high valuation profile, focused on AI infrastructure for future growth.

This business model shift by market dominators of the prior decade rarely results in dominance for the next decade. As Marko Papic of BCA Research argued in March of this year: *"history is a very harsh judge of incumbency amidst technological change. But, more specific to today, AI is simply a general-purpose technology that will enable efficiency in all sectors, including those with far less lofty valuations[13]."*

For today's leading US tech firms to maintain their dominance, they must preserve a durable competitive moat and continue delivering the earnings growth markets have come to expect. However, recent results and forward estimates suggest their leadership is narrowing (chart 8[14]), posing a clear challenge to their long-term position.

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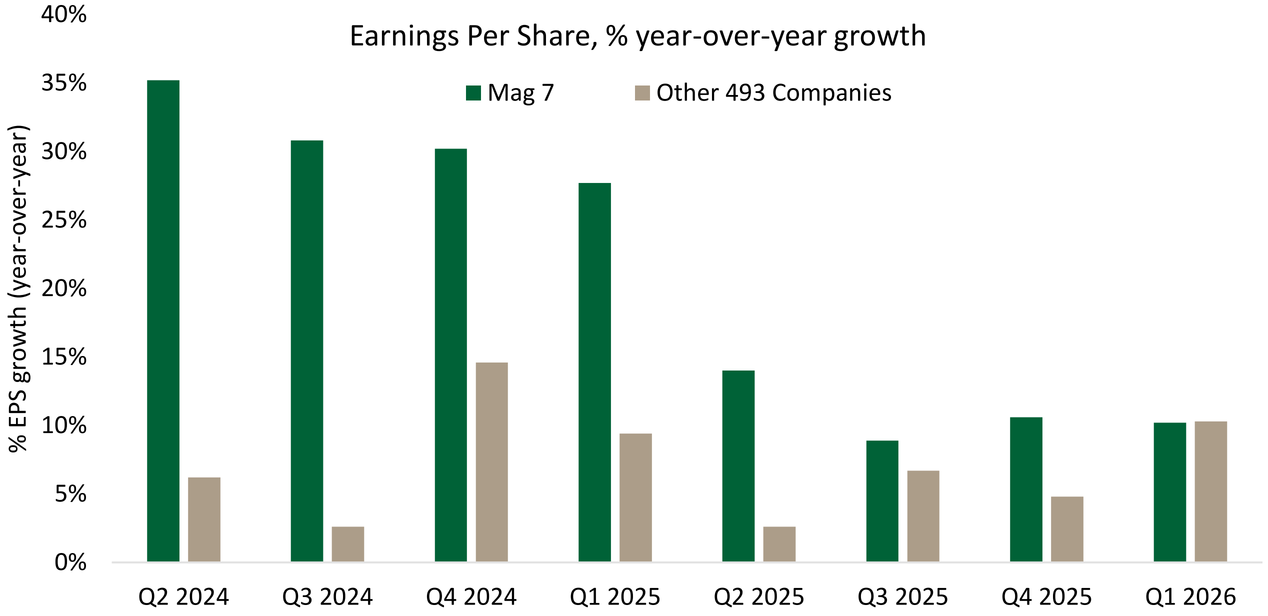
[11] Source: Standard & Poors, June 2025.
[12] Source: Bloomberg, USD, June 2025.
[13] Source: BCA GeoMacro Research, March 2025.
[14] Source: Factset, June 2025

Chart 8: Slowing earnings growth expected for the Magnificent 7 companies



In summary, supportive factors for US equities and the dollar:

- **The US dollar's reserve currency status remains secure**: there are no credible alternatives offering similar scale, liquidity, or institutional strength
- **Fiscal policy is more restrained than widely perceived:** President Trump's spending bill is notably smaller than expected.
- **Further convergence in growth in favour of Europe is unlikely:** Europe has benefited from tariff 'front-running' but faces a number of headwinds in the coming months.
- **US companies continue to benefit from structural advantages:** capital efficiency, productivity, innovation and earnings resilience are expected to remain key characteristics of the US market
- **The US Dollar remains the 'currency of uncertainty':** in an era of heightened geopolitical and economic risks, the greenback retains key defensive qualities during periods of turbulence

Key challenges that may weigh on US assets over time:

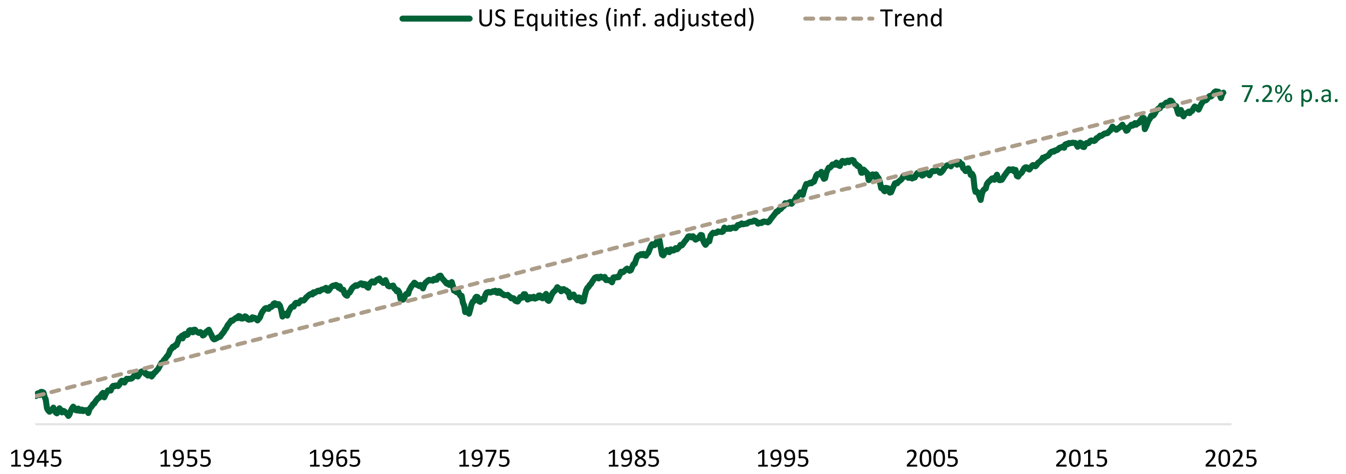
- **The reduction in fiscal stimulus removes a key growth tailwind long term**: this increases the reliance on productivity-led growth to sustain US outperformance
- **The AI cycle is becoming increasingly global**: rising competition and adoption in Asia and beyond challenges US tech dominance
- **The US dollar remains expensive:** when measured on purchasing power parity and real effective exchange rate measures

US assets continue to offer solid fundamentals and defensive qualities, though a shifting global backdrop calls for thoughtful portfolio adaptation. We explore the investment implications in further detail in section 2.

Section 2. Investment Implications: An improved outlook for global diversification

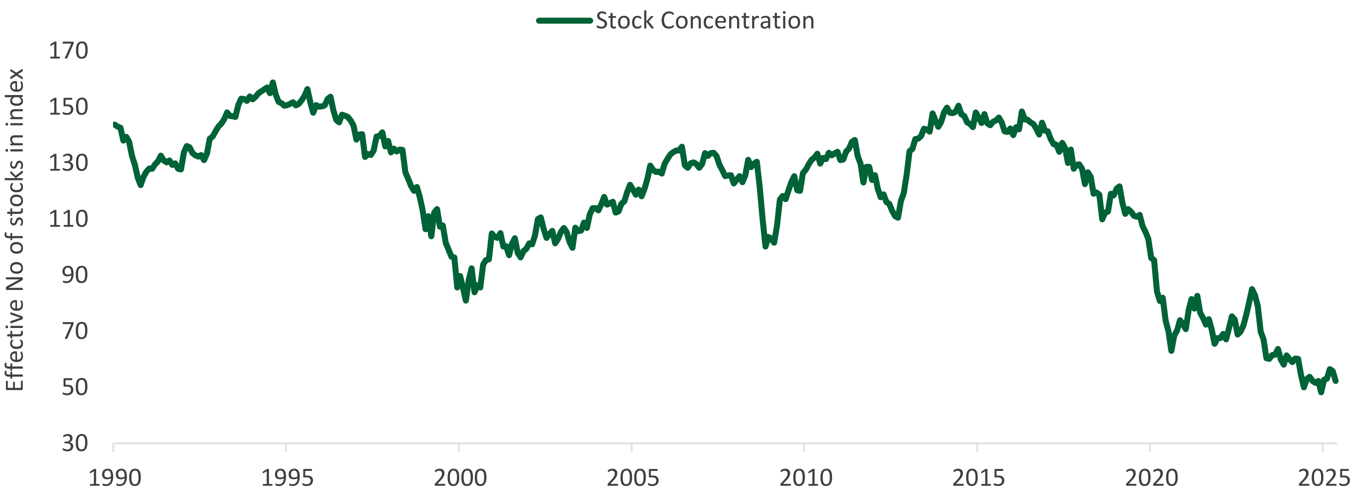
As outlined in Section 1, the US market continues to merit a core allocation in portfolios targeting long-term real returns. Few assets have matched its consistent ability to grow capital ahead of inflation across market and economic cycles. Despite periods of significant stress—including the high inflation of the 1970s, the early 2000s tech bubble, and the Global Financial Crisis—the long-term record of inflation-adjusted returns remains compelling (see Chart 9[15]).

Chart 9: Real US equity returns support a core long term allocation



However, the period from 2010 to 2025 has been defined by an unusually high concentration of returns among a small group of dominant US companies – the Magnificent 7 reviewed in section 1. One of our global active managers describes the past 15 years as a “bear market for diversification,” as the extraordinary outperformance of US technology leaders have significantly diminished the benefits of spreading capital across regions, sectors, and asset classes. A good way to illustrate this is through the Herfindahl-Hirschman index (chart 10[16]) which reflects how many stocks are truly moving the index.

Chart 10: The US market has never been so concentrated



[15] *Source: Shiller Data, USD, June 2025.*
[16] *Source: Bloomberg, Stonehage Fleming Global Best Ideas, June 2025.*

Our primary takeaway from the evolution of the investment landscape in recent months is that the era of market concentration is coming to an end. This is good news for global investors actively seeking broad opportunities.

Having leant into market-cap weighted passives in recent years, capturing US exceptionalism and big tech momentum, our outlook reflects a shift toward broader market participation. Over the past six months, our portfolios have tilted toward global active managers with high-conviction, quality, growth-oriented strategies and clear valuation discipline across sectors and regions.

Accessing the next phase of AI growth

The Artificial Intelligence theme is considered a key long-term driver of growth across industries. While much of the market remains focused on AI infrastructure providers, our emphasis is on how AI is being applied to enhance products and improve operational efficiency across sectors.

Our recent allocation to the Jupiter Global Equity Growth Unconstrained Fund includes Nintendo, using NVIDIA's DLSS to boost graphics in the upcoming Switch 2. This highlights AI's role in enhancing user experience and competitive edge.

In non-life insurance, we allocate to a specialist manager to capture the growing efficiencies from AI adoption. Intact Financial, for example, now uses over 500 AI models to analyse claims and customer interactions, enhancing risk assessment and operational performance. According to CFO Louis Marcotte[17], its Impact Lab is delivering over CAD $100 million in cost savings annually, highlighting the tangible impact of AI on profitability.

Summary: Multi-Asset Strategy to Reflect Disruption and Uncertainty

The investment landscape is increasingly shaped by macroeconomic, geopolitical, and technological disruption. Our investment philosophy remains anchored in our clients' long-term priorities: preserving and growing real wealth within a disciplined risk framework. As such, long-term growth capital—particularly public and private equity—continues to form the core of our portfolio design.

However, the environment is evolving. The portfolio strategies that succeeded over the past 15 years must now adapt to thrive in a new era. This calls for a gradual, conviction-led evolution of our strategy, aligned with long-term opportunities as they arise. The question of long-term US market leadership has been a key focus this quarter, which we have covered at length. While some key tailwinds of recent years are fading, such as big tech dominance and fiscal stimulus, we continue to see relative strength and opportunity in the US market. Yet, the opportunity today is broader, incorporating a wider set of industries, company sizes, and international jurisdiction.

Our clearest conviction today is that the market environment is evolving to the benefit of global portfolios allocating to carefully selected active managers and long-term growth themes.

With the backdrop prone to sudden shifts and short term volatility, we remain vigilant and ready to adjust our strategy as new developments unfold.

Stonehage Fleming Investment Management
Chief Investment Officer Group
08 July 2025

[17] *Source: Louis Marcotte interview with RBC Capital Markets' Innovators and Ideas Series, April 2024.*

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