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2025 Midyear Market Outlook

Investing in a post-globalisation world

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Investing in a post-globalisation world



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and Chief Investment Officer*

The year 2025 was always going to be one of change, but the speed and extent of developments have taken almost everybody by surprise. The full impact of trade policy shifts have yet to unfold, but it is clear that the global trading system is being reconfigured before our eyes, with profound implications for financial markets.

We are undergoing a process of deglobalisation. This will negatively impact the global economy, with the key protagonists, the U.S. and China, hit hardest. It is also a key factor in our outlook for equity, fixed income, and asset allocation investing through the rest of 2025.

The threat of tariffs has brought forward changes in equity markets that had already begun to occur prior to November's U.S. presidential election. The spread of earnings growth between the "Magnificent Seven" group of mega-cap tech stocks and the rest of the U.S. stock market will likely continue to diminish, fueling a period of less concentrated markets and more varied market leadership. We expect this broadening of the opportunity set to include non-U.S. stocks as well.

In bond markets, massive German fiscal expansion, in combination with the U.S. tariff policies, has triggered a global regime change.

Higher-trend inflation—most notably in the U.S.—and a heightened risk of a sharp growth slowdown are pushing developed market sovereign bond yields higher, eroding the quality of developed market sovereign bonds. However, corporate bonds are heading into the difficult period ahead with meaningfully higher overall credit quality than in the past.

The market environment has led our Asset Allocation Committee to favor inflation protected bonds and real assets, such as real estate and commodities, to offset inflation risk. Given the likelihood of continued geopolitical volatility, we are focusing heavily on valuations and continue to favor value stocks over growth stocks. We also modestly favor non-U.S. stocks.

Volatility is elevated, and policy is changeable. We are ready to respond as clarity over tariffs emerges over the coming months. The most important thing is to acknowledge that in the less globalised world ahead, the range and mix of investment opportunities will be different from those to which we have been accustomed. Successfully adjusting to this new reality will demand heightened vigilance, a willingness to let go of old assumptions, and an ability to take decisive action when required.

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Scorecard

	Expectation at start of 2025	How we did	On reflection
Global Economy	— Geopolitical tensions and the likelihood of new tariffs from the U.S. will reconfigure supply chains	✓	— U.S. trade policy proved to be a key factor in shaping markets in the first half of the year
	— U.S. exceptionalism to continue	✗	— The U.S.-induced trade shock was worse than expected, and the German fiscal stimulus package was better than expected; both developments weakened the case for continued U.S. outperformance
Equities	— Earnings growth to broaden beyond U.S. tech stocks to other regions	✓	— Many international stock markets have delivered gains this year, while the S&P 500 Index and Dow Jones Industrial Average have lagged
	— Small-cap stocks to make a comeback	✗	— Small-cap stocks have not yet performed as well as we expected
Fixed Income	— High yield bonds to present income opportunities	✓	— High yield bonds have delivered income, and credit spreads have narrowed following tariff announcement volatility, indicating continuing confidence in the asset class
	— Emerging market (EM) corporates and sovereign bonds to benefit from a favorable growth environment	—	— Emerging market debt has delivered mixed performance this year
Asset Allocation	— Overweight stocks and cash, underweight bonds	—	— We had begun to de-risk, but not enough; our Asset Allocation Committee is now underweight equities
	— Enthusiasm for artificial intelligence (AI) to take a back seat to other market themes	✓	— Tech firm valuations are being challenged amid concerns over the timeline for realising gains from heavy AI investment

"Expectations at start of 2025" are from our 2025 Global Market Outlook, issued in November 2024. The Scorecard does not reflect all views and expectations covered in that report. "How we did" reflects what we got right and wrong as of the time of this writing. The orange dash indicates we were partially right. Future outcomes may differ materially and the information provided is subject to change.

Trump's tariffs will hit the U.S. economy hardest in the near term



Blerina Uruçi
Chief U.S. Economist



Tomasz Wieladek
Chief European
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Chris Kushlis
Chief Emerging Markets
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The Trump administration's tariffs—combined with any retaliatory measures from U.S. trading partners—will, if implemented, deliver a supply shock to the U.S. and a demand shock for the rest of the world. The severity of these shocks will depend on the outcome of ongoing trade negotiations and legal challenges. However, it seems certain that the world's two largest economies, China and the U.S., will experience lower economic growth than projected at the beginning of the year—and the ramifications of this will be felt across the globe irrespective of any individual trade deals struck.

The U.S. faces downside risks to the growth outlook even as higher reciprocal tariffs with China and other trading partners have been paused. Businesses face rising input costs, which would squeeze profit margins and force some firms to reduce investment spending. Tariffs on consumer goods will likely reduce real purchasing power and slow consumer spending, which accounts for more than 70% of U.S. gross domestic product. Any further downward pressure on the U.S. dollar could exacerbate upside risks to inflation.

The U.S. labor market has remained resilient so far, but recent data confirm that it has transitioned from exceptionally tight in 2022–2023 to more balanced now. This implies a thinner cushion for the labor market than

at any point in the post-pandemic period. In the event of a large and persistent shock to economic activity, a pickup in the pace of layoffs would push up the unemployment rate.

The U.S. Federal Reserve (Fed) is in a difficult position as it balances the risk of tariff-fueled inflation with supporting a weakening economy. This tension will likely linger through 2025. President Donald Trump has been leaning heavily on the Fed to cut rates, but the Fed's independence remains intact for now. For the remainder of the year, we expect the focus to be on deregulation and fiscal measures such as tax cuts, which could deliver a boost for U.S. growth. We will monitor these developments closely as they would pose upside risks to both the growth and inflation outlooks.

China's more focused trade war gives it more options

As the main target for U.S. tariffs, China also faces economic headwinds in the second half of the year, albeit different in nature and probably less severe than those the U.S. faces. Although negotiations between the two countries have resulted in lower tariffs, those currently in place will still have a major impact on U.S.-China trade.

One advantage China has is that while the U.S. is busy fighting a trade war with almost every country in the world, it is only fighting one against the U.S. As such, China will likely seek to reship many of its goods through other countries with lower tariffs. If this happens at scale, it will mitigate the growth and deflationary pressures China faces, although it may not be enough to prevent a growth slowdown. We expect Beijing to use a combination of monetary and fiscal stimulus to offset the drag on growth from tariffs, but any such measures will be taken sequentially and in response to data rather than being rolled out all at once.

No region unaffected by battle of the heavyweights

Despite being lowered from the levels previously threatened, the U.S.'s tariffs on China will still impact the eurozone in several ways: First, because weaker growth will reduce China's demand for European exports; second, because Chinese manufacturers seeking to redirect their exports away from the U.S. will provide more intense competition for European exporters in other markets; and third, because a surge of Chinese imports will contribute to goods disinflation within the eurozone itself.

Combined with the direct impact of the eurozone's own trade tensions with the U.S., these secondary impacts from China will likely contribute to slowing growth in Europe in the second half of the year. Inflation should continue to decline in the near term, and while Germany's debt brake reform will eventually provide a boost to the eurozone economy, this may take some time to materialise. Negotiated wage growth in the eurozone is expected to continue falling, giving the European Central Bank further latitude to cut rates—and we expect it to do so several times before inflation risks rise again in 2026.

Deflationary pressure in China is also likely to spill over into other emerging markets (EMs) as Chinese goods are redirected to other countries in the region, lowering prices. Weaker global growth and lower commodity prices may bring further disinflationary pressures in EMs, with commodity producers likely to remain under pressure. Given the uncertainty, most EM central banks will be cautious and wait for the data to tell them what to do next—although the weaker U.S. dollar will give some of them more room to cut rates without risking a currency sell-off or inflation spike.

Key takeaway

The world's two largest economies will be most affected by tariffs, with inevitable consequences for all other regions.

Global economy buffeted from multiple directions

(Fig. 1) Fiscal reform and deregulation could partially offset tariff impact

U.S. labor market has thinnest cushion since pandemic

German debt brake reform should unleash investment in Europe

China's economic outlook challenged despite trade agreement with U.S.



Tax cuts and deregulation could boost U.S. growth

Policy uncertainty will continue to weigh on investment

Deflationary pressure from China could spill into emerging markets

As of May 31, 2025.

For illustrative purposes only. Actual future outcomes may differ materially from forward-looking statements.

Source: T. Rowe Price.

Equity markets to broaden further



Josh Nelson

Head of Global Equity



Scott Berg

*Portfolio Manager,
Global Equity*

An expanding opportunity set in stock markets was on its way before Donald Trump was elected U.S. president; the trade policies he has implemented since taking up office have merely sped up the process. This expansion of investable stocks will take place both within the U.S. market and abroad. We are returning to an environment in which more sectors and regions can work—one demanding diversification and favoring active management.

Broadening market leadership has already begun to occur: Many overseas stock markets have outperformed their U.S. counterparts this year. This expansion of leadership should continue in the second half of the year. Although the Trump administration's tax cut and deregulation agenda will deliver a boost to the U.S. economy, this will likely be balanced out in the near term by ongoing uncertainty over tariffs and their impact on U.S. consumers and businesses.

At the same time, the era in which the “Magnificent Seven” group of mega-cap tech stocks dominated the S&P 500, and by extension helped U.S. stocks to dominate the world, could be transitioning to a new phase where a broader cross-section of stocks outperform. The spread of earnings growth between technology stocks and the rest of the S&P 500 has been narrowing, and we expect this to continue (Figure 2).

The specific securities identified and described are for informational purposes only and do not represent recommendations.

The emergence of start-ups such as China's DeepSeek are showing that AI innovation is no longer concentrated in a handful of trillion-dollar companies.

As U.S. inflation remains higher for longer, value stocks—which historically have outperformed growth stocks in inflationary environments—are expected to become more competitive again. Value sectors such as energy, materials, and industrials historically have performed well during inflationary periods.

India and Argentina stand out among emerging markets

Opportunities for regional diversification are likely to come mainly in EM countries. Of these, India looks well positioned after two terms under Prime Minister Narendra Modi have delivered solid economic growth, reforms, and investment. With its large, domestically driven economy, India is more insulated from tariff-related volatility than many of its rivals and has sufficient critical mass—measured in economic scale, infrastructure, digital adoption, and the expansion of the middle class—to continue its growth path. While Indian stock valuations remain elevated, the market's resilience and strong economic fundamentals should not be underestimated if buying opportunities occur.

“Germany’s decision to end its longstanding debt brake will enable increased investment....”

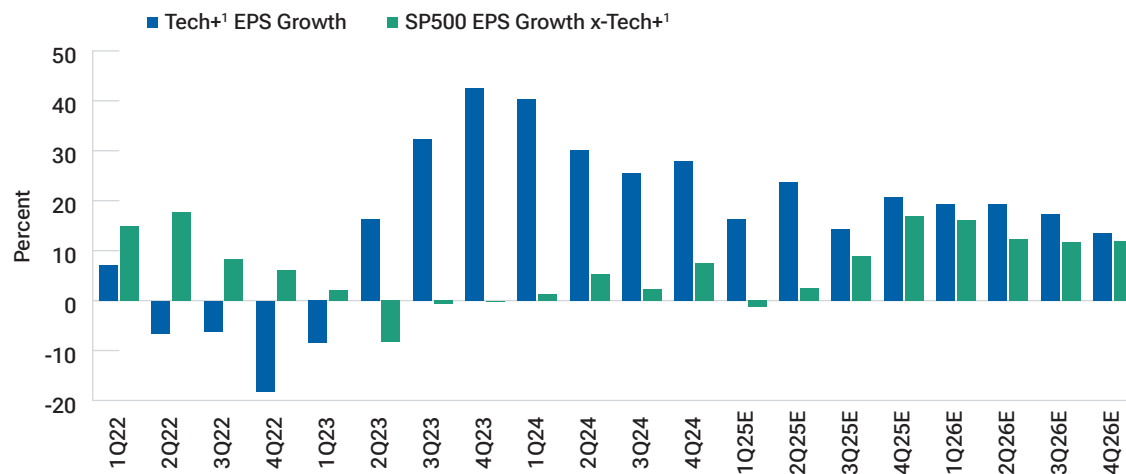
– Josh Nelson
Head of Global Equity

Argentina continues to catch the eye amid ongoing reforms under President Javier Milei. His administration's efforts to balance the budget and control inflation have helped to transform Argentina's economic prospects, which have been further boosted by a USD 20 billion loan from the International Monetary Fund. The risk premium associated with Argentine stocks means they remain attractively valued, offering discounts compared with some of their regional peers.

Indonesian and Saudi Arabian stocks are also expected to perform well as part of a broader tilt toward international equities. However, some other countries, notably Vietnam, face a somewhat more challenging period ahead as they navigate U.S.-China tensions.

Tech stock dominance is fading

(Fig. 2) The spread of earnings growth between tech and other sectors is narrowing



As of December 31, 2024.

Sources: Standard and Poor's, Refinitiv, FactSet, UBS. See Additional Disclosures.

¹ TECH+ is the Technology Sector including Interactive Media & Services, Interactive Home Entertainment, Netflix from Movies & Entertainment and Amazon.

E = Estimates. Actual outcomes may differ materially from estimates.

European stocks are attractively valued

Outside of emerging markets, European stocks have outperformed U.S. stocks this year and appear well placed to continue doing so. European equities are trading at lower price-to-earnings ratios than their U.S. counterparts and are more likely to benefit from a central bank rate cut. Germany's decision to end its longstanding debt brake will enable increased investment and defense spending, while

the prospect of reduced trade with the U.S. might persuade the European Union to introduce much-needed reforms.

One area to monitor is the fluid situation with tariffs, as shown in the U.S.'s decision on May 23 to impose a 50% rate on European Union goods only to postpone it a few days later. The size, scope, and speed of tariff implementation could bring further volatility for both U.S. and European stocks.

Finally, while Japan has been hit harder than Europe by Trump's tariffs given its greater dependence on exports to the U.S., Japanese stocks appear undervalued compared with historical norms and global peers. Japan's strong underlying fundamentals—including a robust corporate sector, high savings rates, ongoing corporate governance reforms, and the return of positive inflation—remain in place and will be supportive, particularly if it strikes a favorable trade deal with the U.S.

As equity market leadership becomes less concentrated, the mix of opportunities will likely broaden across sectors and countries. Successfully navigating this environment will require diversification¹ and a renewed focus on identifying high-quality companies. A broader market provides more opportunities, but it also brings additional risk.

Key takeaway

The broadening of equity market leadership should favor value stocks and select emerging markets such as India and Argentina.

¹ Diversification cannot assure a profit or protect against loss in a declining market.

Bonds with credit risk may outperform government debt



Paul Massaro, CFA®
Head of Global High Yield
and Chief Investment
Officer, Fixed Income



Ken Orchard, CFA®
Head of International
Fixed Income

Already this year, two events have occurred that have broken historical precedent and shifted the global fixed income landscape. The massive German fiscal expansion and the Trump administration's tariffs have resulted in a weaker outlook for developed market sovereign bonds and a stronger one for credit and some emerging markets. More recently, rising anxiety over the U.S.'s fiscal position led to a sell-off in U.S. Treasuries.

The combination of recent events has triggered a global regime change. One of the most conspicuous symptoms of this is that above-target inflation in some developed markets looks here to stay. The inflation outlook is particularly downbeat for the U.S., where we expect the tariff-induced supply shock to produce a material bump higher in prices despite lower oil prices offsetting some of the upward pressure in the short term. With inflation currently running at an elevated 2.5%–3.0%, it is difficult to see it reaching the Federal Reserve's 2% target over the next few years.

The likelihood of a global recession—with the U.S. leading the downturn—has also increased. Even if President Trump lowers tariffs from their current levels or abandons them entirely, there will be lingering damage as the uncertainty of the on-again, off-again trade levies at varying levels has damaged corporate and consumer

confidence. Instead of a traditional recession, what may transpire—especially in the U.S.—is a longer period of subpar growth with both higher unemployment and higher inflation.

Higher inflation to keep Fed on hold despite slowing growth

The mix of structurally higher inflation and the higher probability of a steep downturn in growth means that the Fed's monetary policy is essentially on hold for the time being. Outside the U.S., where inflationary pressure is somewhat lower, other developed market central banks have more room to lower rates.

In the short term, we expect continued volatility as fixed income markets work through the implications of regime change. Over the longer term, European growth, driven by Germany's aggressive fiscal expansion, should recover relatively quickly. Global inflation is likely to push higher amid supply problems stemming from the trade war. We expect to see higher yields as investors anticipate the erosion of developed market sovereign bond values by inflation.

Bond markets at a glance

(Fig. 3) Six key data points



4.40%

10 Year U.S. Treasury yield as of May 31, 2025¹



Euro 500Bn

Fiscal expansion announced by Germany on March 4, 2025



6.2%

U.S. budget deficit forecast as percent of GDP for fiscal year 2025.²



2.50%

10 Year German Bund yield as of May 31, 2025¹



5%

U.S. high yield approximate default rate estimated prior to April tariff announcements



7.73%

Yield to worst of the U.S. high yield market.³

¹ Bloomberg Finance L.P. Yield to maturity is the total return anticipated on a bond held to maturity assuming all the securities are held to maturity.

² Source: Congressional Budget Office, as of January 17, 2025.

³ As of March 31, 2025. The Yield of the High Yield market is represented by the Bloomberg US HY 2% Issuer Capped Bond Index. Yield to worst is a measure of the lowest possible yield on a bond whose contract includes provisions that would allow the issuer to redeem the securities before they mature. Source: Bloomberg Finance L.P. For illustrative purposes only.

Improved overall quality to bolster corporate credit

This outlook does not bode well for high-quality global sovereigns over the long term. However, the picture is a little different for fixed income sectors with credit risk. As of late May, credit spreads¹ have narrowed to near-record lows after the sell-off in April's turbulence, so they could certainly widen further in the near term. However, corporate bond markets—both investment grade and high yield—are going into this economic downturn with meaningfully higher overall credit quality than in the past.

One-third of the non-investment-grade bond market is secured,² or backed by collateral that goes to the bondholder in the event of default. In another indication of higher credit quality and recession resistance, the amount of non-energy cyclical sector exposure in the Bloomberg U.S. High Yield 2% Issuer Cap Index was about eight percentage points lower as of March 31, 2025, than 10 years earlier. From a broader point of view, the average credit rating of the non-investment-grade index was higher as of the end of March than it was 10 years ago.

That said, some of the weaker high yield issuers in sectors dependent on consumer spending could default as tariffs slash their profit margins. Prior to the early April tariff announcements, our high yield credit analyst team anticipated a 2025 U.S. default rate of about 5%.³ We now think it could drift higher but doubt that it will reach the 7%–8% level experienced following the onset of the pandemic in 2020.

¹ Credit spreads measure the additional yield that investors demand for holding a bond with credit risk over a similar-maturity, high-quality government security.

² Source: J.P. Morgan.

³ Default estimate includes both traditional defaults and distressed exchanges. If a distressed exchange is deemed likely for an issuer, we consider all the securities of that issuer within the index to be in default. Actual outcomes may differ materially from estimates.

High yield and select emerging market bonds offer meaningful diversification

Shorter-maturity investment-grade corporate bonds should hold up better than longer-maturity corporates in an environment of increasing long-term government yields. In the high yield market, shorter-maturity bonds with early refinancings ahead of maturity dates are also potentially attractive.

Within the non-investment-grade market, we modestly favor bonds over bank loans because loans are generally trading at higher prices currently, giving them less price appreciation potential. Also, loans—which have floating rate coupons that adjust in lockstep with short-term interest rates—are exposed to spreads widening in a recession at the same time that coupons are dropping if the Fed is forced to cut rates.

In international markets, bonds from emerging markets that are less exposed to the tariff war—particularly those in Latin America and Eastern Europe—could hold up surprisingly well, providing attractive opportunities for yield and diversification. Another advantage of emerging market exposure is that some higher-quality emerging market sovereigns have been less volatile than developed market government bonds, including U.S. Treasuries.

“This outlook does not bode well for high-quality global sovereigns...”

Key takeaway

Corporate bonds are entering a likely economic downturn with historically high credit quality, positioning them more defensively than in the past.

Uncovering opportunities amidst tariff truce and beyond



Wenli Zheng

Portfolio Manager,
China Evolution Equity Strategy

Tariff truce eases tensions

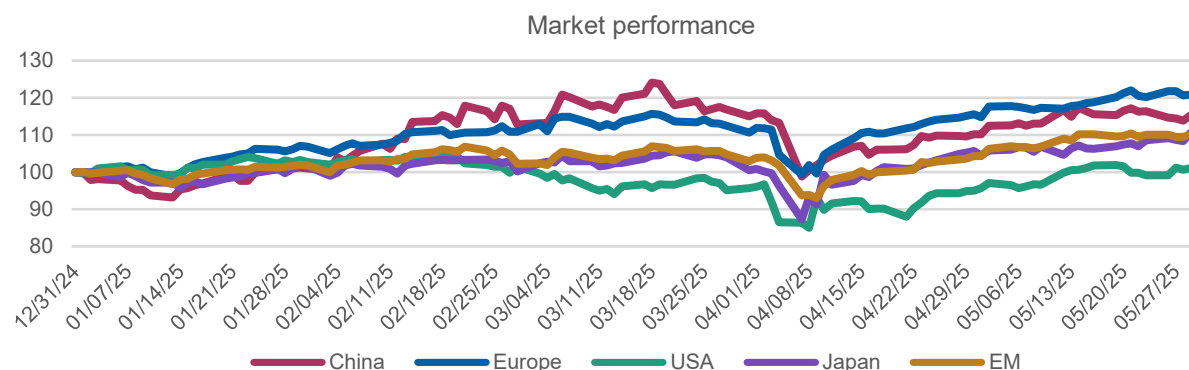
On May 12, 2025, the U.S. and China significantly rolled back tariffs on each other's goods for an initial 90-day period. The U.S. reduced tariffs on Chinese goods from 145% to 30%, while China cut retaliatory tariffs on U.S. goods from 125% to 10% for the period. Additionally, President Trump's revised executive order lowered tariffs on small packages valued under USD800 from 120% to 54%. While further developments in trade talks are

expected ahead, the truce was well received by the markets, with the MSCI China Index climbing 17% since April 7, 2025, lifting year-to-date returns to 15% (as of April 16, 2025).

At the expiry of the 90-day window, we might see further escalation or de-escalation. Regardless of the outcome of the trade deal, several trends are emerging, poised to reshape the global economic landscape and redefine investment opportunities.

China (red line) remains one of the best performing equity markets year-to-date

(Fig. 4) MSCI equity indices in U.S. dollars indexed to 12/31/2024 = 100.



Past performance is not a guarantee or a reliable indicator of future results.

Source: FactSet, MSCI, returns in U.S. dollars.

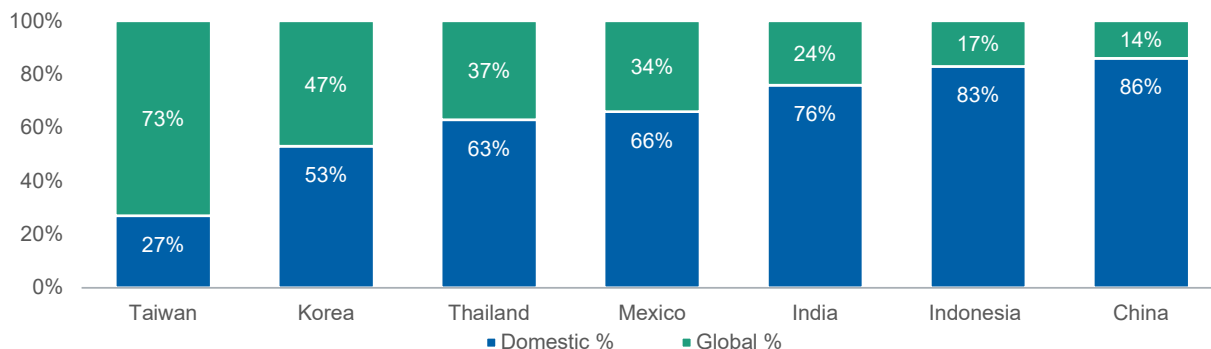
As of May 30, 2025.

“Regardless of the outcome of the trade deal, several trends are emerging, poised to reshape the global economic landscape...”

Corporate revenue exposure: Domestic versus global percentage shares

(Fig. 5) Based on MSCI indices with calculations by Goldman Sachs Global Investment research.

Revenue exposure % Domestic vs Global

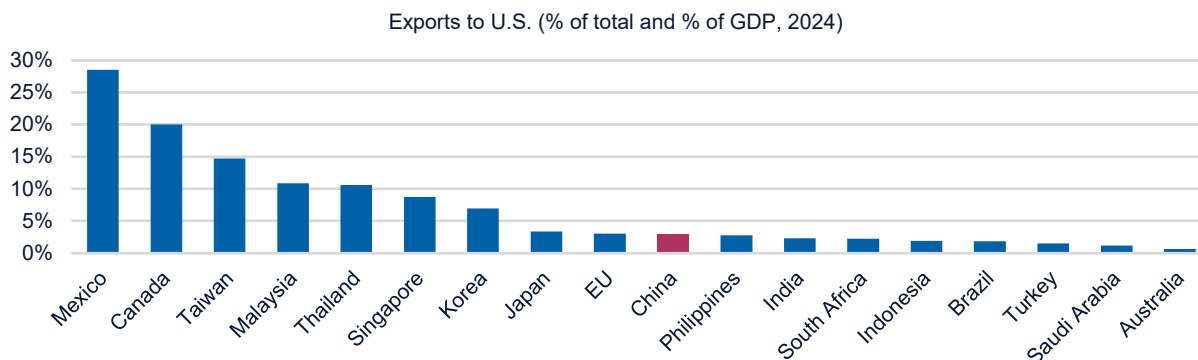


As of April 30, 2025.

Sources: Financial data and analytics provider FactSet. Copyright 2025 FactSet. All Rights Reserved, MSCI, Goldman Sachs Global Investment Research.

China's huge economy is not heavily dependent on exports to the U.S.

(Fig. 6) Exports to the U.S. as a percentage of GDP (2024 data)



Sources: Financial data and analytics provider FactSet. Copyright 2025 FactSet. All Rights Reserved, MSCI, Goldman Sachs Global Investment Research. 2024 annual data.

Transformation of global supply chains

The U.S. is advancing its reindustrialisation agenda, with tariff policies as a cornerstone. This strategy prioritises strategic sectors such as semiconductors, electric vehicles, pharmaceuticals, steel, and shipbuilding. As a result, global supply chains in these industries are undergoing significant disruption and reconfiguration. The highly integrated, globalised supply chain model is giving way to a more regionalised yet interconnected framework. This shift presents challenges for all economies, but those with robust domestic markets and comprehensive industrial ecosystems are better equipped to adapt.

China's resilience amid tariff pressures

With lingering uncertainties from tariffs, it's helpful to assess their potential impact on the Chinese economy.

Over the past decade, China has implemented proactive measures to mitigate external pressures. The Belt and Road Initiative has broadened access to global markets, diversifying trade partnerships, while the "dual circulation" strategy has fortified domestic economic resilience. Additionally, breakthroughs in critical technologies have eased supply-side bottlenecks, and deleveraging in the financial and real estate sectors has reduced systemic risks, positioning China to better absorb potential shocks.

The economic impact from tariffs is moderated by China's reduced reliance on U.S. markets. In 2024, exports to the U.S. (including re-exports) accounted for approximately 3% of China's GDP, down from 6% in 2010, reflecting a significant shift in trade dynamics.

At the corporate level, the impact of tariff escalation is limited for most Chinese firms, with U.S. exports comprising only around 1% of the average revenue of listed companies—one of the lowest U.S. exposures globally. Escalation may exacerbate slower economic growth, but firms are adapting by accelerating globalisation strategies.

Since 2018, many have pivoted from export-focused models to globalised operations, a trend likely to intensify. Companies with advanced technologies and operational agility are well-placed to seize opportunities, even in a volatile trade environment, supporting long-term equity resilience.

Domestic demand as the economic anchor

1. Building a more balanced economy

Enhancing domestic consumption aligns with China's internal needs and is essential in the current external environment. This transition will be supported by strengthening the social safety net, improving healthcare, and expanding educational opportunities. The investment focus is expected to shift from "hardware" (infrastructure) to "software" (human capital).

2. A stabilising property sector

The real estate sector is showing signs of stabilisation, with housing starts declining by 68% from the peak in 2021, which had significantly impacted the overall economy. However, inventories in major cities are nearing normalised levels. While we do not anticipate a strong rebound, we do expect the negative impact to diminish over the next one to two years.

3. End market improvements

After several years of downturn, specific end markets are beginning to show improvement, particularly in construction machinery, wind power, automation, and railways.

Multifaceted opportunities

1. Evolving consumer trends

The consumer market is undergoing a transformation. Selective businesses in traditional categories, such as dairies and beer, are seeing incremental improvement with companies' self-help measures. Meanwhile, hotel chains and shopping malls are experiencing steady growth through market consolidation. Furthermore, we are witnessing the emergence of new consumption patterns, particularly in intellectual property, fresh beverages, and snacks, signaling a dynamic shift in consumer preferences and behaviors.

“At the corporate level, the impact of tariff escalation is limited for most Chinese firms...”

“Enhancing domestic consumption aligns with China's internal needs...”

2. Technological innovation

While Deepseek has highlighted China's capabilities in AI, rapid technological advancements have been occurring over the past few years and are expected to accelerate further. Although China faces constraints in computing power, we think that it is well-positioned for the application and commercialisation of AI technologies. For instance, in the automotive sector, China has established strong leadership in electric vehicles (EVs) and is expected to potentially lead in autonomous driving. In biotechnology, China has transitioned from a generative market to an innovation powerhouse, with approximately 30%-40% of global biotech out-licensing originating from China in 2024.¹

3. Dislocation opportunities

Market dislocation has presented bottom-up investors with opportunities to capitalise on indiscriminate sell-offs by acquiring export-related stocks that have been oversold.

Companies with forward-looking strategies and flexible approaches stand to gain market share as the market evolves. Staying calm and conducting objective fundamental analysis can help investors uncover undervalued investment opportunities in China with significant potential.

Key takeaway

Companies with forward-looking strategies and flexible approaches stand to gain market share as the market evolves.

¹ Source: China Pharmaceutical Industry Research Development Association. As of April 5, 2025.

Inflation protection and equity diversification to drive asset allocation



Tim Murray, CFA®
Capital Markets Strategist

While we anticipated a deglobalisation process following the pandemic-induced supply chain snarls in 2020, the threat of tariffs has brought globalisation under attack. Countries and companies are scrambling to reduce their exposure to tariffs, greatly accelerating the deglobalisation trend. This process will have significant implications for asset allocation as some previously favored assets become less attractive and others show more potential.

One thing is clear—the Federal Reserve will stick to its data-dependent approach, avoiding forward guidance, and continue to assiduously avoid any messaging that could be interpreted as political. Fed policymakers know that lower rates are not a cure for uncertainty, so we do not expect a “Fed put” in the form of an interest rate cut over the near term. We see little chance that the central bank will lower rates until a major increase in the unemployment rate shows that a recession is obviously imminent.

The Fed is also reluctant to cut rates because of the risk that tariffs will pressure inflation higher. We are mindful of this possibility and favor exposure to inflation protected bonds and real assets like real estate and commodities as tools to help offset inflation risk. Our Asset Allocation Committee (AAC) holds an underweight

position in longer-term U.S. Treasuries as they could underperform amid resurgent inflation. Additionally, Treasuries face growing scrutiny from foreign investors due to concerns about fiscal sustainability and economic policy uncertainty.

Growth stock valuations remain elevated

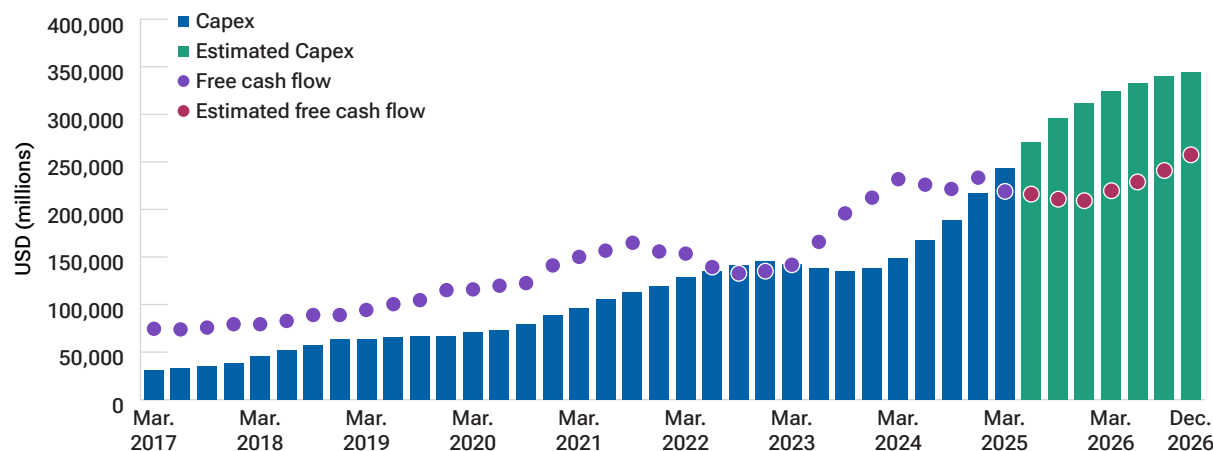
In times of rapid geopolitical change, we tend to lean more heavily than usual on asset class valuations. Even after the concentrated selling pressure on growth stocks and value's relative outperformance in early 2025, value equities appear to provide more valuation support than growth.

In artificial intelligence, the tremendous advantages of being on the right side of change, as illustrated during the shifts toward digital media, online retail, and cloud computing, appear to have flattened out. As a result, the tech giants are spending heavily on AI to try to ensure they maintain their positions on the leading edge of technology. We believe this spending will be profitable over the longer term, but time horizon is important. These innovative firms could see their valuations challenged over the near term by flattening returns on equity while their capital expenditures are elevated (Figure 7).

“Countries and companies are scrambling to reduce their exposure to tariffs, greatly accelerating the deglobalisation trend.”

Capex is beginning to weigh on mega-cap tech cash flow

(Fig. 7) Capex vs. free cash flow for Microsoft, Alphabet, Amazon, and Meta, collectively



As of March 31, 2025. Q1 2017 to Q1 2025. Q2 2025 to Q4 2026 are estimates for Capex and Free Cash Flow.

The specific securities identified and described are for informational purposes only and do not represent recommendations.

Source: T. Rowe Price analysis using data from FactSet Research Systems Inc. All rights reserved. Please see Additional Disclosures page for additional legal notices and disclaimers.

These data are for illustrative purposes only, representing 4 mega-cap tech companies collectively. They do not represent all mega-cap tech companies. Actual future outcomes may differ materially from estimates. This is not a recommendation to buy or sell any security. Capex = Capital Expenditures.

Trade war to dampen traditional U.S. equity advantage in a downturn

In a typical economic growth downturn or recession, we would expect U.S. equities to hold up better than international stocks. But we believe the underlying dynamics of this year's slump may be different, leading us to modestly favor non-U.S. shares.

One factor working against U.S. equities is the inflationary pressure from tariffs that will keep the Fed on hold unless

a recession is inevitable. Outside the U.S. (and Japan, where the Bank of Japan has been gradually raising rates), central banks have more leeway to lower rates—and mortgage rates are more responsive to cuts, so the benefits flow through the economy faster.

Finally, the recent landmark decision by Germany to loosen its debt brake on defense spending and create a EUR 500 billion infrastructure fund is a dramatic change after more than a decade of austerity measures. This pivot could eventually provide a much-needed

fiscal boost to the European economy, which has been operating below capacity for most of the past 15 years, supporting the Continent's equity markets.

All of these factors, combined with the sizable weighting of the mega-cap tech firms in growth stock indexes, led the AAC to a relative underweight to U.S. growth equities.

Corporate governance reforms continue to support Japanese equities

Japan still stands out among international equity markets because of its positive momentum toward stronger corporate governance. The country's steady progress toward a healthy level of inflation and domestic consumption should also support its stock market. While exports are a major driver of Japan's economy, making it particularly sensitive to U.S. tariffs, Japan appears motivated to negotiate with the Trump administration to lower tariffs.

Key takeaway

Our Asset Allocation Committee holds underweight positions in both long-term U.S. Treasuries and U.S. stocks.

2025 tactical allocation views

As of May 31, 2025



T. Rowe Price multi-asset positioning—asset class



Stocks

We remain cautious on equities given extended valuations, optimistic earnings projections, and a still uncertain path on trade policy. Within equities, we continue to favor value-oriented sectors, which are supported by more reasonable valuations, deregulation, and economic activity broadening beyond AI infrastructure-driven spending.



Bonds

We maintain an underweight position to bonds given the possibility of upward pressure on U.S. interest rates reflecting potential for increased supply to accommodate U.S. fiscal spending. We are maintaining an overweight to high yield as fundamentals remain broadly supportive and default risk remains low even in a slower economic environment.



Cash

We remain overweight to cash/cash equivalents, as it provides attractive yields and liquidity to try to take advantage of market opportunities amid expected volatility.

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T. Rowe Price multi-asset positioning—regional



U.S.

U.S. equities face a challenging macro environment due to policy uncertainty, stubbornly high interest rates, elevated valuations, and overly optimistic earnings estimates. Innovation advantages remain an important differentiator, but rising capex budgets could weigh on mega-cap tech earnings over the near term.



Europe

Increased fiscal spending, monetary easing, and reasonable valuations could provide upside. However, trade uncertainty clouds the near-term outlook, and a dearth of innovation leaders remains a longer-term challenge.



UK

Valuations are attractive and the longer-term outlook is healthy. But economic growth may be challenged and fiscal vulnerabilities remain.



Japan

Corporate governance continues to steadily improve, while modestly higher inflation and rising wages are having a positive impact on consumption. But higher interest rates and trade uncertainty could weigh over the near term.



Canada

Economic growth is weak but poised to accelerate due to both fiscal and monetary stimulus. However, much of the optimism is already factored in to stock prices.



Australia

Earnings growth remains a concern, though the economy does appear to have stabilised. Labor market data are volatile, which may complicate the easing cycle.



Emerging Markets

EM stock and currency valuations are attractive and benefiting from capital flight out of the U.S. Tariff uncertainty remains a notable area of concern, though some areas, notably Latin America, may be less impacted.



China

Credit conditions appear to be bottoming, the housing sector is stabilising, and further policy support is expected. However, structural economic challenges remain a concern and trade policy uncertainty poses a potential headwind.

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T. Rowe Price multi-asset positioning—stocks



U.S. Growth

AI monetisation and capex spend continues to be scrutinised, though Magnificent Seven earnings have largely held up. Valuations remain elevated, and earnings estimates are optimistic despite economic uncertainty.



U.S. Mid-Cap

Mid-cap offers higher-quality earnings growth relative to small-cap and less exposure to higher interest rates. Meanwhile, deregulation and broader economic growth should provide support.



U.S. Value

There is potential for support from deregulation, continued broadening of earnings growth, as well as prospective fiscal policy support and reshoring; however, policy uncertainty could pose a risk to economic growth.



U.S. Small-Cap

Economic growth uncertainty and lack of pricing power could pose challenges. However, potential for deregulation and stronger mergers and acquisitions activity could be supportive.



Global Ex-U.S. Growth

Growth stocks' valuations are more expensive and are more levered to global trade. Persistent consumer weakness in emerging markets presents another headwind.



Global Ex-U.S. Large-Cap

Trade uncertainty and geopolitical risk remain concerns; however, an improving stimulus outlook, stabilisation in Chinese growth, and a weaker dollar offer support.



Global Ex-U.S. Value

A paradigm shift in the fiscal spending outlook combined with still dovish monetary policy and a normalised interest rate environment should catalyse improvement.



Global Ex-U.S. Small-Cap

Monetary easing, fiscal spending, a weaker dollar, and less exposure to trade policy could provide tailwinds, combined with still attractive valuations.



U.S. Large-Cap

Elevated valuations and concentration risks remain a concern. However, strong fundamentals and healthy free cash flow levels offer a buffer against economic slowdown.



Real Assets Equities

The sector offers hedging against sticky inflation. AI infrastructure spend, reorientation of supply chains, and trade policy uncertainty are all likely to place upward pressure on commodity prices. Additionally, peaking U.S. oil productivity should drive oil prices higher over the long term.

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T. Rowe Price multi-asset positioning—bonds



U.S. Investment Grade (IG)

Yields could be biased higher on sticky inflation and uncertainty around deficits and policies. Credit fundamentals are supportive, with spreads reflecting uncertainty.



Global High Yield

Spreads remain vulnerable to market uncertainty, but the sector offers a healthy yield with supportive fundamentals and still muted default expectations.



Developed Ex-U.S. IG (USD Hedged)

Hedged yields are more attractive with potentially less upward pressure on the longer end than U.S. Treasuries, while central banks have more room to cut.



Floating Rate Loans

Valuations have become more reasonable and the sector may benefit in a scenario where Fed rate cuts are more limited than markets currently price. However, liquidity considerations amid market uncertainty are likely to weigh on the asset class.



U.S. Long-Term Treasuries

Despite lower growth expectations, increasing concerns around stickier inflation and prospects for increased issuance to sustain fiscal deficits may bias yields higher.



Emerging Market Dollar Sovereigns

Despite attractive yields, risks to EM include tighter financial conditions from potentially higher U.S. interest rates and tariff uncertainty.



Inflation Linked

Inflation could remain sticky or surprise higher in the coming months due to effects from trade policies, a tight labor market, and unanchored inflation expectations.



EM Local Currency Bonds

Recent U.S. dollar weakness has been supportive, though the path forward for the U.S. dollar and fiscal challenges from tariffs both remain uncertain.

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Appendix

Investment Risks:

Active investing may have higher costs than passive investing and may underperform the broad market or passive peers with similar objectives. Each person's investing situation and circumstances differ. Investors should take all considerations into account before investing.

International investments can be riskier than U.S. investments due to the adverse effects of currency exchange rates, differences in market structure and liquidity, as well as specific country, regional, and economic developments. The risks of international investing are heightened for investments in emerging market and frontier market countries. **Emerging and frontier market countries** tend to have economic structures that are less diverse and mature, and political systems that are less stable, than those of developed market countries.

Commodities are subject to increased risks such as higher price volatility, geopolitical and other risks. Commodity prices can be subject to extreme volatility and significant price swings.

TIPS In periods of no or low inflation, other types of bonds, such as US Treasury Bonds, may perform better than Treasury Inflation Protected Securities (TIPS).

Investing in **technology stocks** entails specific risks, including the potential for wide variations in performance and usually wide price swings, up and down. Technology companies can be affected by, among other things, intense competition, government regulation, earnings disappointments, dependency on patent protection and rapid obsolescence of products and services due to technological innovations or changing consumer preferences.

Because of the cyclical nature of **natural resource companies**, their stock prices and rates of earnings growth may follow an irregular path.

The **value approach** to investing carries the risk that the market will not recognise a security's intrinsic value for a long time or that a stock judged to be undervalued may actually be appropriately priced. **Growth stocks** are subject to the volatility inherent in common stock investing, and their share price may fluctuate more than that of an income-oriented stock.

Small-cap stocks have generally been more volatile in price than the large-cap stocks.

All investments involve risk, including possible loss of principal. Diversification cannot assure a profit or protect against loss in a declining market. Index performance is for illustrative purposes only and is not indicative of any specific investment. Investors cannot invest directly in an index.

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