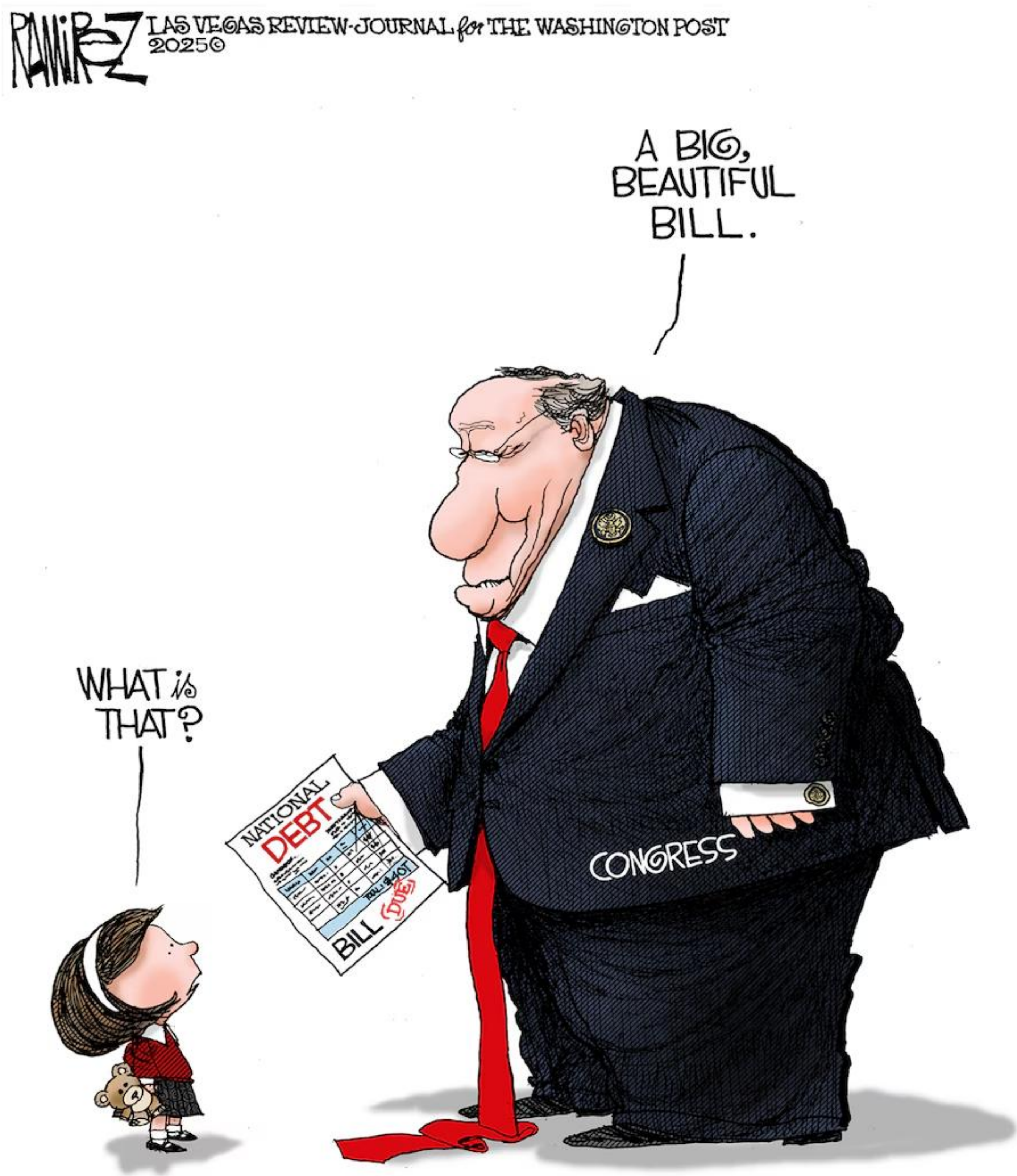
June 2025



RAMIREZ
LAS VEGAS REVIEW-JOURNAL for THE WASHINGTON POST
2025©
A BIG, BEAUTIFUL BILL.
WHAT is THAT?
NATIONAL DEBT
TOTAL: $40T
BILL (DUE)
CONGRESS

From the front page of Tuesday's WSJ:

Stocks Sit At Record Highs After Wild Quarter

BY KRYSTAL HUR

A historic and tumultuous quarter ended with U.S. stocks at records and many investors betting the ride isn't over yet.

The April swoon that carried the S&P 500 to the brink of a bear market has been erased and then some. The broad index has now added more than 9% since President Trump announced sweeping tariffs that sparked havoc in markets.

Now, investors have more reasons to feel upbeat. Both the S&P 500 and Nasdaq Composite Index are hitting fresh all-time highs. Robust corporate earnings and solid economic data suggest that growth remains resilient. Inflation is trending near the Federal Reserve's 2% target. Banks that slashed their year-end targets for the S&P 500, such as JPMorgan Chase and Goldman Sachs, are raising them again. ...

The S&P 500 notched its best quarterly performance since 2023, and the Nasdaq saw its biggest quarterly jump since 2020. ...

That optimism has fueled fresh gains for some recent stalwarts. The artificial-intelligence trade has rebounded from a rocky start to the year, when the emergence of Chinese upstart DeepSeek's AI model erased billions of dollars of value from Nvidia and other tech giants.

Nvidia shares have climbed 18% this year, Meta Platforms has gained 26% and Microsoft has added 18%. ...

The price of bitcoin has climbed back above $100,000, with Trump, a Republican, reaffirming his promise to make the U.S. the "crypto capital of the planet" and Congress seeking to advance legislation that could integrate crypto into the mainstream financial system. Coinbase led the recovery from the April lows, rising around 130%.

At the same time, some (including HCM) warn that it is just a matter of time before tariffs hurt economic growth, rekindle inflation and weigh on corporate earnings.

Such worries have the Fed pausing its interest-rate reductions, while concerns about Trump's tax bill and the massive U.S. deficit have weakened the dollar. (see below)

The yield on the benchmark 10-year Treasury note settled at 4.227% to close out the first half, below where it ended last year at 4.577%, according to Tradeweb. ...

Investors' worries have also manifested in a dizzying rally in haven assets including gold. Gold futures have posted a 25% gain in 2025, marking their best start to a year since 1979. A 24% gain in silver futures, meanwhile, marks their best first half performance since 2016.

Shares of economically resilient companies such as utilities— which investors often buy when they are nervous about growth—have also outpaced the S&P 500's year-to-date 5.5% gain. Meanwhile, stocks that tend to rise when the economy is booming, such as the consumer-discretionary sector and small-caps, are lagging behind. ...

Adding to investors' concerns, some of the "Magnificent Seven" tech heavyweights that have powered market gains in recent years have lost their luster. Shares of Tesla have tumbled about 21% this year, dragged down by weak sales in China and consumer backlash to Elon Musk's role, and later, fallout, with the Trump administration. Shares of Apple and Alphabet have declined about 18% and 7%, respectively, with investors worrying the companies have fallen behind in the AI race.

Analysts polled by FactSet expect companies in the S&P 500 to report earnings growth of 9.4% this year, below the 14.3% they expected in January.

Still, analysts project earnings will rise 13.7% next year. Many remain hopeful that the economy can dodge the worst of the trade fight and that negotiations will produce deals mitigating the fallout.

And despite stocks looking pricey—the S&P 500 was recently trading at 22 times its expected earnings over the next 12 months, above its 10-year average of 18.7 times—many think indexes can still rise from here.

From Monday's WSJ What's News:

The U.S. dollar is headed for its worst first half of a year in at least four decades.

The ICE U.S. Dollar Index is down more than 10% in 2025, the biggest drop in data going back to 1985, according to Dow Jones Market Data. The decline impacts the global economy because the dollar is the primary currency for trade and finance. Concerns about tariffs, the Fed's independence and growing U.S. government debt have weighed on the dollar.

From last Thursday's Global Investment Strategy:

Third Quarter 2025 Strategy Outlook: Waiting For The Whites Of The Recession's Eyes

I. Macroeconomic Outlook

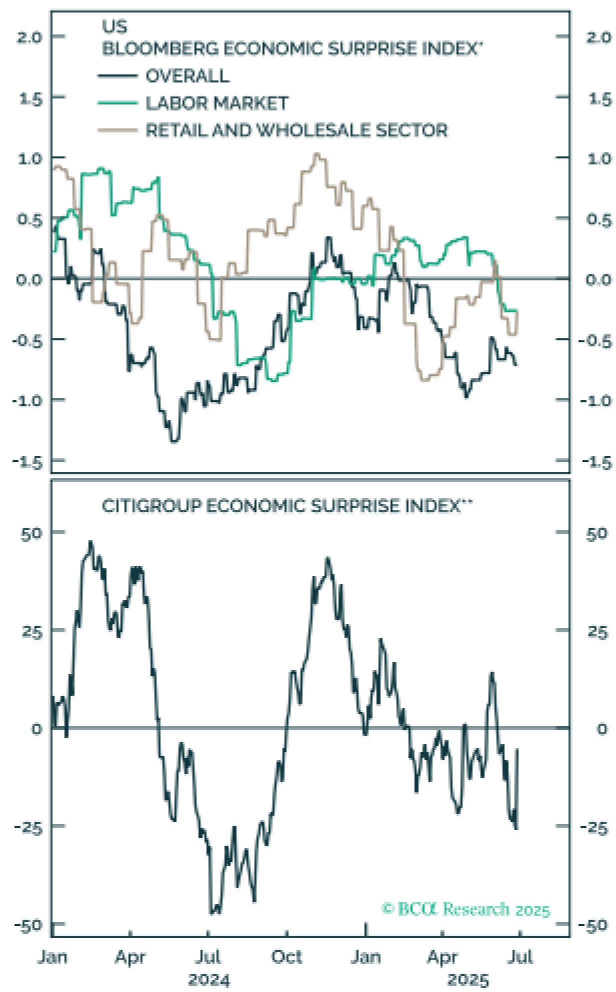
The US Economy: Will the Narrative Shift?

Financial markets are usually driven by a single narrative which persists until something comes along that subverts it in favor of another narrative. Since President Trump paused the Liberation Day tariffs, the narrative has been "the economy was fine before the trade war began; now that Trump is pivoting from tariffs to tax cuts, everything will be fine again." There are three problems with this narrative: First, neither the US economy nor the global economy were in such great shape before the trade war began. Second, Trump has not abandoned tariffs. Third, any benefits from more unfunded tax cuts could be undermined by the bond market. Let us examine each issue.

How Resilient Is the US Economy?

In our December 2024 Annual Outlook, we speculated that the US would enter a recession in May of this year. While that did not happen, growth does appear to be nearing stall speed. Real GDP contracted by 0.5% in Q1, with overall consumer spending rising by just 0.5%. Services spending, which should be largely immune to trade distortions, increased by a mere 0.6%.

CHART 1
US Economic Data Have Surprised To The Downside



* SOURCE: BLOOMBERG FINANCE L.P.
** ROLLING 3-MONTH STANDARD DEVIATION OF DATA SURPRISES. SOURCE: CITIGROUP GLOBAL MARKETS INC.

The Atlanta Fed's GDPNow model has consumer spending growing by 1.9% in Q2. However, that estimate has fallen from 4% at the start of June and is liable to be revised down further based on the fact that the recent data on retail and wholesale trade have been surprising on the downside **(Chart 1)**.

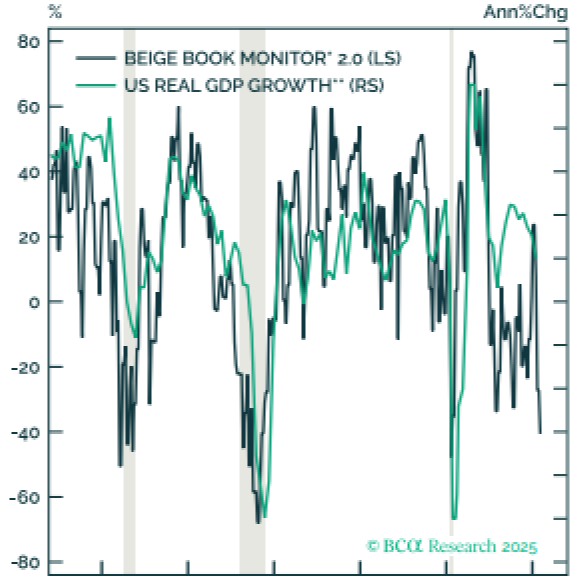
The May Beige Book stated that *"Reports across the twelve Federal Reserve Districts indicate that economic activity has declined slightly since the previous report. Half of the Districts reported slight to moderate declines in activity, three Districts reported no change, and three Districts reported slight growth."* Outside of the pandemic period, our Beige Book monitor – which tracks the net number of positive versus negative words in the publication – has dropped to its worst level since the Great Recession **(Chart 2)**.

US Labor Market Continues to Soften

At his press conference last week, Jay Powell characterized the labor market as "solid" and said that it is "not crying out for a rate cut." We would respectfully disagree.

CHART 2

The Beige Book Monitor - An Economic Sentiment Indicator - Has Dropped To Its Worst Level Since The Great Recession



* NUMBER OF "STRONG" WORDS MINUS "WEAK" WORDS AS A PERCENT OF TOTAL IN THE BEIGE BOOK.
** SHOWN TRUNCATED AT -4% AND 6%.
NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS.

Although payrolls did rise by 139K in May, that number is likely to be revised lower. On the initial release dates, payroll growth averaged 174K in Q1 2025. However, after two sets of revisions, the Q1 average has come down to 111K. And this is before the annual benchmark revisions. According to the Quarterly Census of Employment and Wages, which is a key input into the benchmark revisions, monthly payrolls were overstated by around 75K in 2024. Assuming that this bias persisted into 2025, May payroll growth will probably come in around 50K when all is said and done.

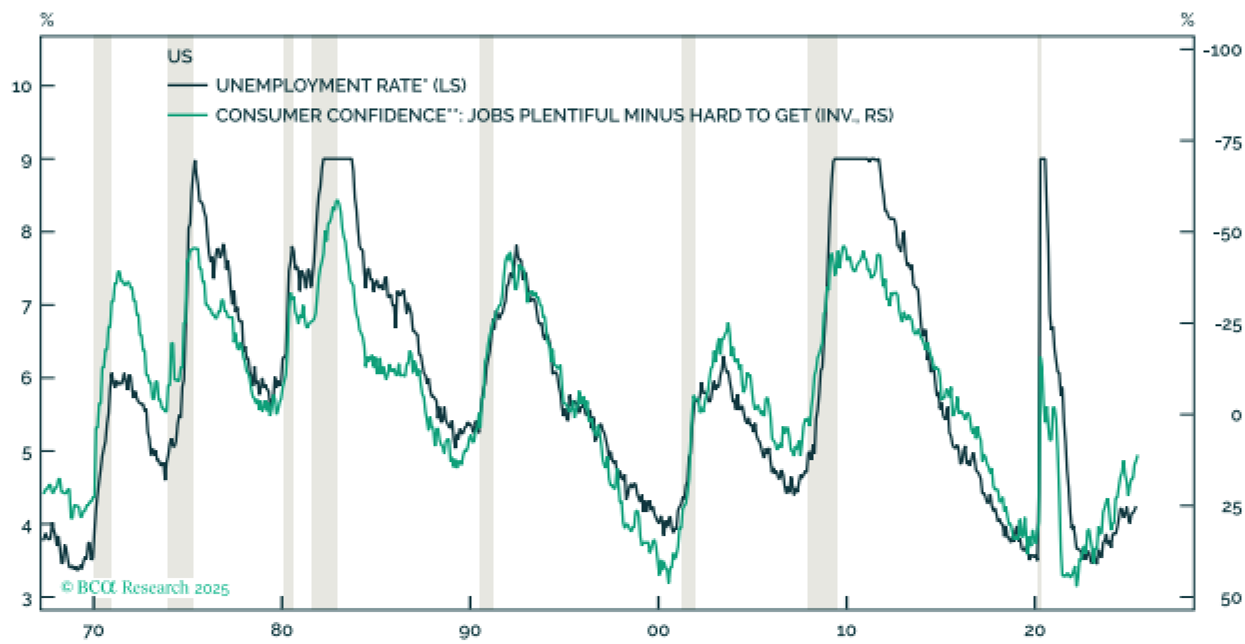
The insulation that surrounded the labor market in 2022 and 2023 – and kept us optimistic on growth when most others were predicting an imminent recession – has eroded. After surging during the pandemic, the job openings rate hit 4.4% in April. ...

Real-time measures of job openings from Indeed and LinkUp have fallen since April. ...

Consistent with that prognosis, the unemployment rate has risen for four straight months on an unrounded basis, reaching the highest level since October 2021 in May. Perceptions of job availability in the Conference Board survey have deteriorated and are now substantially worse than in 2019 **(Chart 5)**. Both initial and continuing

CHART 5

Unemployment Is Slowly Trending Higher, While Perceptions Of Job Availability Have Deteriorated



* SOURCE: BUREAU OF LABOR STATISTICS (BLS). SERIES TRUNCATED AT 9%.
** SOURCE: THE CONFERENCE BOARD.
NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS.

unemployment claims are trending higher.

The outlook has turned particularly grim for young college graduates. Unlike in past economic cycles, their unemployment rate is higher than for other workers.

Slower Employment Growth Will Weigh on Income and Spending

US real disposable income growth picked up at the start of the year, largely due to retroactive benefit payments made under the Social Security Fairness Act. However, underlying real wage and salary growth has continued to slow.

Looking out, weaker labor demand will weigh on payroll growth, while decreased immigration should curb employment in those sectors of the economy that have historically depended on cheap foreign labor.

Researchers at the Brookings Institution and the American Enterprise Institute reckon that migration could turn negative in 2025 for the first time in 50 years. While lower immigration subtracts from labor supply, it also subtracts from labor demand. Consequently, falling immigration may not prevent the unemployment rate from rising.

High Tariffs Will Sap Real Incomes

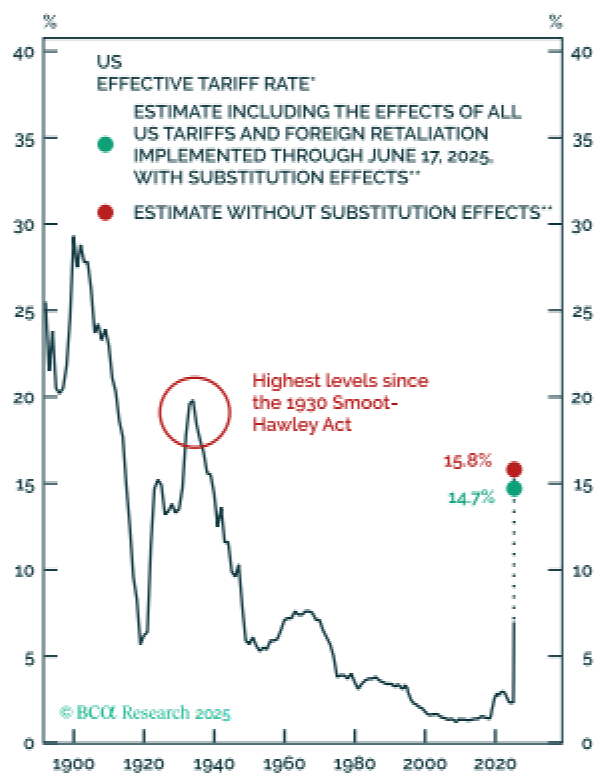
Although foreign automakers have cut import prices to some extent, overall import prices (which are calculated prior to the imposition of tariffs) have not fallen since the start of the trade war. The main reason that US inflation has not risen is because importers have largely absorbed the cost of tariffs.

The decision of US companies not to raise prices is understandable. Not only is aggregate demand on a weaker footing than in 2021, but higher prices could destroy customer goodwill and invite backlash from President Trump.

Nevertheless, the existing state of affairs cannot persist indefinitely. The US effective tariff rate stands at 16%, the highest since the 1930s **(Chart 10)**. As Walmart and other companies have noted, if the current tariff rate persists, they will have no choice but to raise prices. The Yale Budget Lab estimates that a continuation of today's tariff rates will ultimately reduce real incomes by 1.7% for the median household, and even more for poorer households.

Unless financial markets force Trump's hand, it is doubtful that tariff rates will fall very much. Instead of 90 deals in 90 days, the only deal that the Trump administration has managed to reach is a not-even-legally binding agreement with the UK. Meanwhile, there are ongoing Section 232 investigations into copper, lumber, semiconductors, pharmaceuticals, trucks, critical minerals, and commercial aircraft. The conclusion of

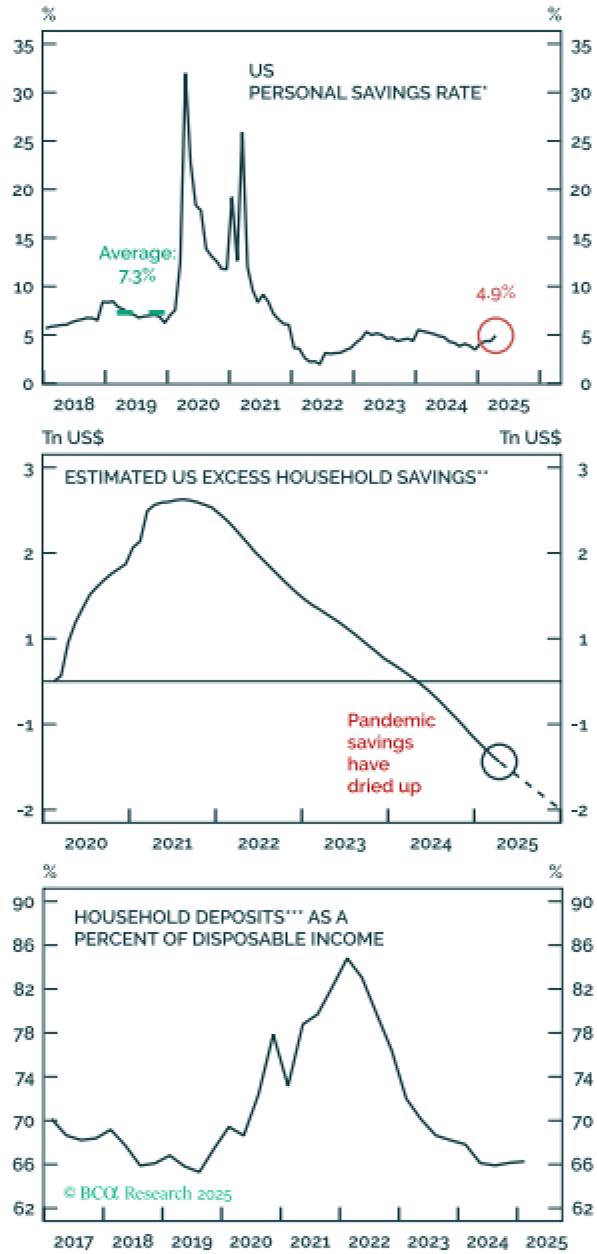
CHART 10
Trump Paused Tariffs, But They Remain At The Highest Level Since The 1930s



* DUTIES COLLECTED AS A PERCENT OF IMPORTS. CALCULATED USING 12-MONTH MOVING TOTALS UNTIL JANUARY 2025, AFTER WHICH THE DATA IS UNSMOOTHED. SOURCE: US INTERNATIONAL TRADE COMMISSION AND CENSUS BUREAU.
** SOURCE: "STATE OF U.S. TARIFFS: JUNE 17, 2025," THE BUDGET LAB AT YALE, JUNE 17, 2025.

those investigations later this year is likely to result in higher tariffs in those industries.

CHART 12
Pandemic Savings Have Been Depleted



* SHOWN AS A PERCENT OF DISPOSABLE INCOME. SOURCE: BUREAU OF ECONOMIC ANALYSIS (BEA).
** SOURCE: "DATA REVISIONS AND PANDEMIC-ERA EXCESS SAVINGS", H. ABDELRAHMAN AND L. OLIVEIRA, FEDERAL RESERVE BANK OF SAN FRANCISCO, NOVEMBER 8, 2023.
*** HOUSEHOLD AND NONPROFIT ORGANIZATIONS' CHECKABLE DEPOSITS, CURRENCY, AND TIME AND SAVINGS DEPOSITS.

Consumer Delinquencies Remain Elevated

In the absence of stronger income growth, US consumers will be hard-pressed to maintain their current pace of spending. Although the savings rate has ticked up in recent months, it remains below where it was in 2019. Excess pandemic savings have been depleted **(Chart 12)**. As a share of disposable income, household bank deposits are back to pre-pandemic levels.

Delinquency rates on credit cards and auto loans are back to 2011 levels – a year in which the unemployment rate was double what it is today. Student loan delinquency rates have spiked following the expiration of debt moratoriums last year. Almost 10 million Americans are currently delinquent on their student loans, around half of whom have not made a single payment in over 360 days.

Housing In The Doldrums

Residential investment is the most forward-looking sector of the economy. Unlike other components of GDP which only decline during recessions, residential investment usually starts falling before a recession begins.

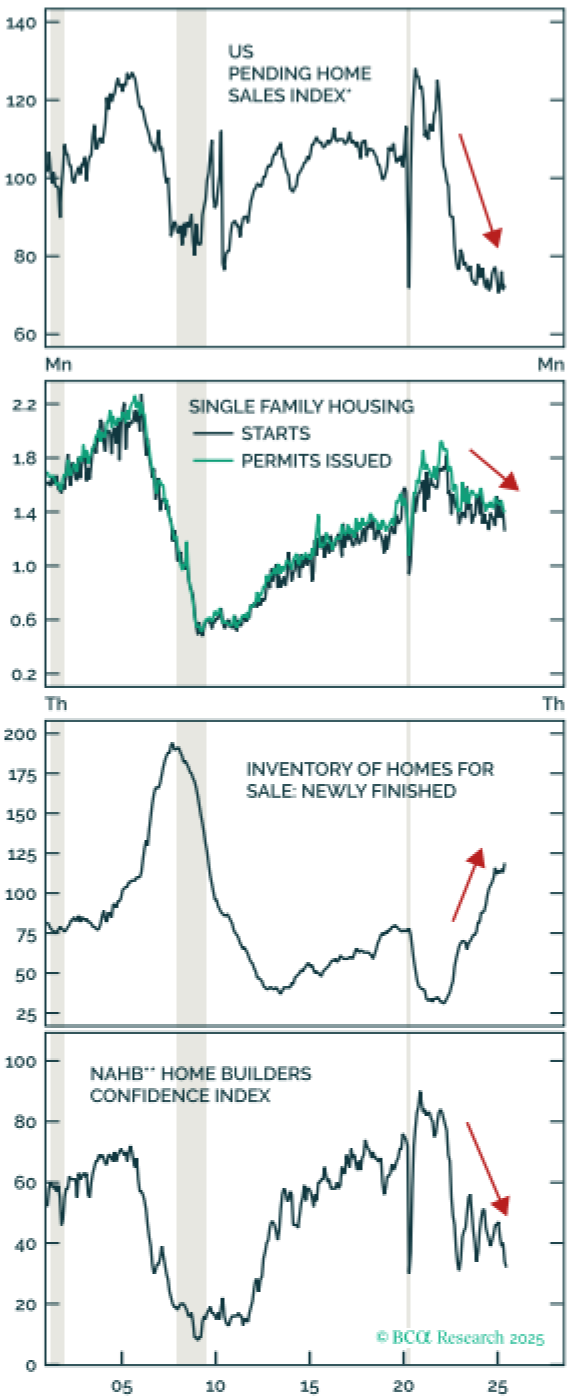
In this regard, it is concerning that US residential investment contracted by 1.3% in Q1 and is on track to shrink by 4.4% in Q2, according to the Atlanta Fed's GDPNow model. Housing starts, building permits, and both new and pending home sales have all weakened of late. New home inventories have surged to the highest level since late 2009 **(Chart 14)**.

Both the Case-Shiller home price index and the FHFA index have fallen in recent months. According to Zillow, home prices declined in more than 60% of US counties in May. The only two times this has happened previously was during the 2022 rate-hiking cycle and during the GFC housing bust **(Chart 16)**.

Not surprisingly, homebuilder confidence is downbeat. Homebuilder shares are 33% below their 52-week highs.

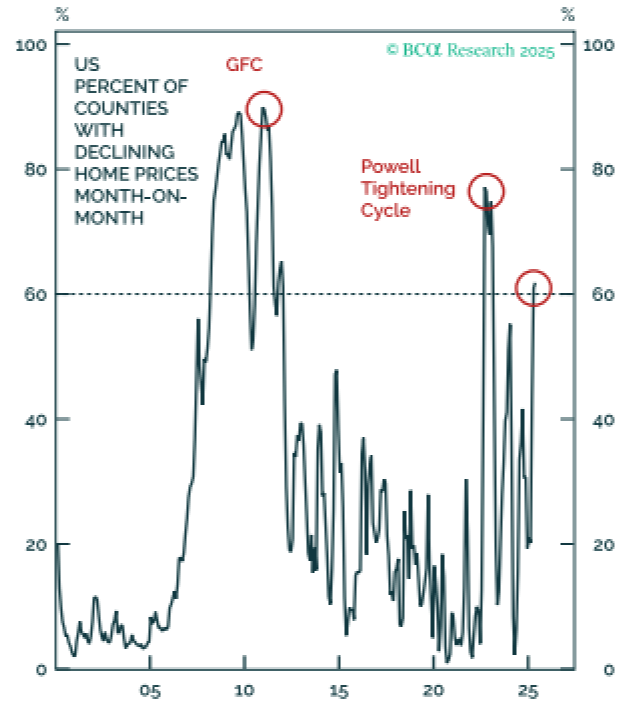
New homeowners today must allocate a larger share of their incomes to servicing their mortgages than at the peak of the housing bubble in 2006 **(Chart 17)**. Currently, one-fifth of mortgages sport a rate above 6%, up from less than 4% of all mortgages in the first half of 2022. The share of high-rate mortgages will continue to rise over time, given that the average mortgage rate is still 2.7 percentage points below the rate on new mortgages.

CHART 14
US Housing In The Dumps



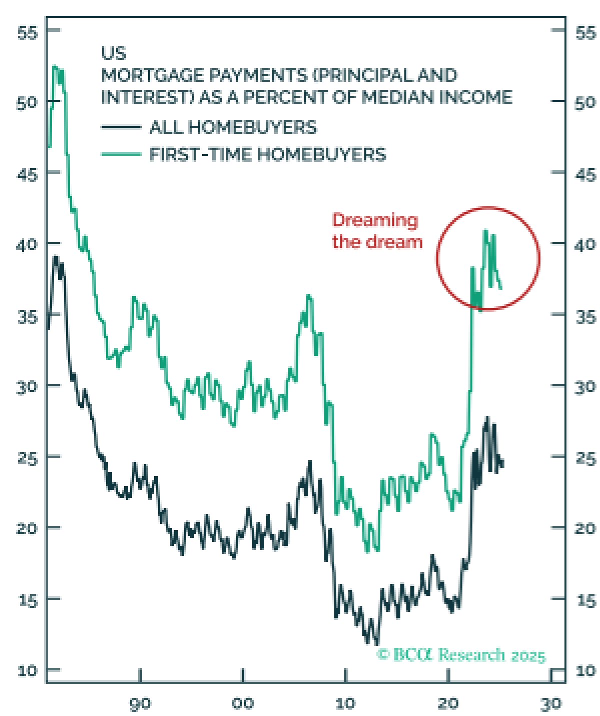
* VOLUME INDEX (2001 = 100). SOURCE: NATIONAL ASSOCIATION OF REALTORS.
** NATIONAL ASSOCIATION OF HOME BUILDERS.
NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS.

CHART 16
According To Zillow, Over 60% Of US Counties Are Experiencing Falling Home Prices



SOURCE: ZILLOW.

CHART 17
New Homeowners Must Allocate A Larger Share Of Their Incomes To Service Their Mortgages Than During The Housing Bubble Peak



SOURCE: NATIONAL ASSOCIATION OF REALTORS.

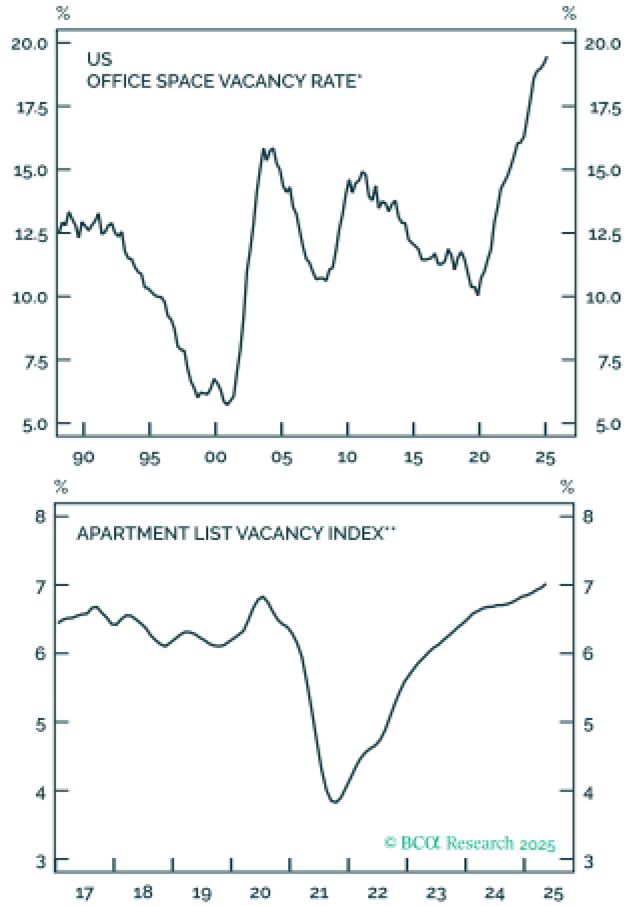
CRE on the Ropes

The outlook also remains challenging in the commercial real estate sector. Nationwide office vacancy rates stand at record highs. The average selling price of office buildings has dropped 37% since 2019.

In the apartment sector, vacancy rates are now slightly above pre-pandemic levels, having almost doubled since October 2021 **(Chart 19)**.

Delinquency rates on commercial real estate loans continue to trend higher. Suspiciously, smaller banks are reporting much lower delinquency rates than larger banks. Most likely, there is a lot of "extend and pretend" going on among smaller CRE lenders. Collectively, regional banks account for around 70% of CRE loans.

CHART 19
CRE Vacancy Rates Are Climbing



* SOURCE: NCREIF.
** RATIO OF VACANT UNITS-TO-TOTAL UNITS AMONG PROPERTIES THAT LIST ON APARTMENT LIST PLATFORM. SOURCE: APARTMENT LIST.

Somber Capex Outlook

Capex was one of the few bright spots in an otherwise dismal Q1 GDP report. Real business equipment spending surged by nearly 24% at an annualized pace during the quarter. The healthy pace of capex growth appears to have continued into Q2, with core capital goods orders coming in above expectations in May.

It remains to be seen how much of the recent rise in capital spending has been due to tariff front-running. With memories of pandemic supply-chain disruptions still top of mind, it is likely that some US companies bought foreign equipment (and some foreign companies bought US equipment) out of fear of looming shortages or price hikes.

Looking out, our capex intentions indicator points to downside risk for capital spending **(Chart 21)**. Although intentions perked up in May after crashing in April, they appear to have relapsed again in June. For example, in the June Philadelphia Fed survey, the net proportion of firms planning on increasing capex over the next six months dropped to 15% from 27% in May.

The reluctance of firms to expand capacity is understandable. Building a new factory that will only be profitable if tariffs stay in place is risky given the uncertainty over the course of trade policy.

The Trump administration's disparagement of the IRA and the CHIPS act has also weighed on capital spending. ... the surge in manufacturing construction during the Biden administration coincided with the passage of both acts. Although data center construction remains buoyant, this has not prevented overall manufacturing construction from stagnating.

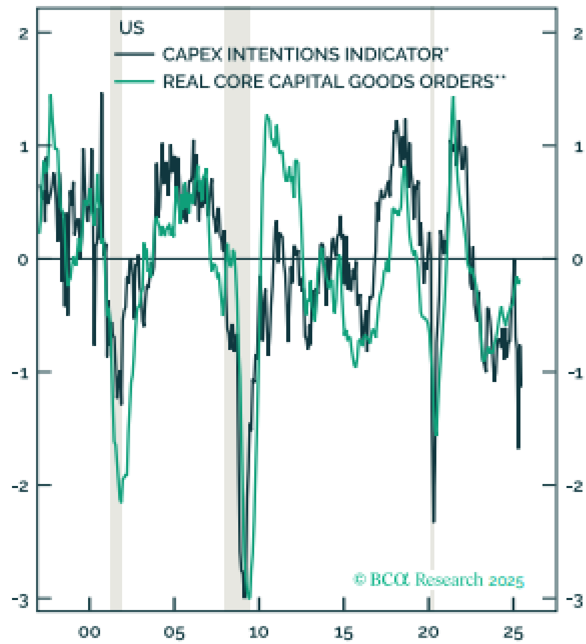
Big Beautiful Debt Bomb?

The One Big Beautiful Bill Act (OBBBA) has the potential to offset some of the impact of tariffs and other headwinds facing the US economy. While the spending cuts in the OBBBA are back-loaded, the incremental tax cuts will reach the economy immediately. Thus, even relative to current policy – which assumes that the tax cuts passed during Trump's first term remain in place – the new Act will still increase the budget deficit by 0.9% of GDP in 2026 (Chart 23).

The problem is that the OBBBA is making its way through Congress at a time when the budget deficit is already over 6% of GDP, or about 3% of GDP more than what is needed to stabilize the debt-to-GDP ratio. Consequently, the Congressional Budget Office (CBO) expects the federal government debt-to-GDP ratio to climb from 98% in 2024 to 124% in 2034. The CBO foresees interest payments on the federal government debt rising from 3.1% of GDP to over 4% of GDP over this period **(Chart 24)**.

If anything, the CBO projections may be too optimistic. Not only do they assume that the politically contentious cuts to health care and income support in the Act are implemented, but they foresee an average 10-year yield of 4% over the next decade – lower than the current yield.

CHART 21
Capex Intentions Are Weak



* AVERAGE OF STANDARDIZED CAPITAL EXPENDITURE EXPECTATIONS FOR THE NFIB SURVEY (3-TO-6 MONTHS), DALLAS, KANSAS CITY, NEW YORK EMPIRE, PHILADELPHIA, AND RICHMOND FED REGIONAL SURVEYS (6 MONTHS). LATEST DATA POINT IS AN ESTIMATE.
** STANDARDIZED ANNUAL PERCENT CHANGE OF 3-MONTH MOVING AVERAGE OF MANUFACTURING NONDEFENSE CAPITAL GOODS EXCLUDING AIRCRAFT. DEFLATED BY PPI FOR PRIVATE CAPITAL EQUIPMENT.
NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS. SERIES TRUNCATED AT -3.

Trade War Is Weighing On Canada's Economy

Tariff front-running propped up US demand for foreign goods earlier this year. This artificial support is now fading. Nowhere is this more evident than in Canada, where Trump's tariffs are already having a sizable negative effect. Exports to the US represent 20% of Canadian GDP and currently face an average tariff rate of around 11%. Manufacturing sales fell 2.8% in April, following a 1.4% drop in March.

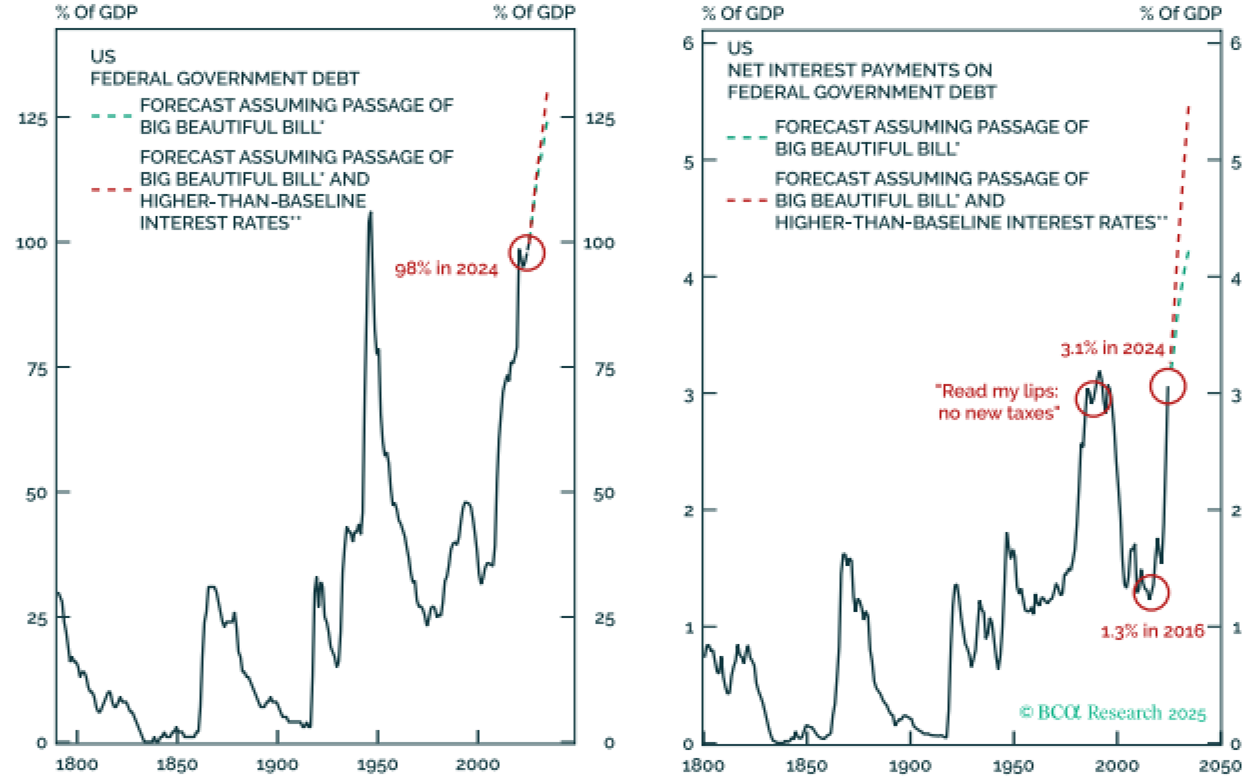
The S&P Global Canada Composite PMI rose to 45.5 in May 2025 from 41.7 in April. However, this still marked the sixth consecutive monthly decline in private-sector activity. Both the manufacturing and services sectors contracted. The Ivey Purchasing Managers Index, which covers all sectors of the Canadian economy, remained in contractionary territory in May.

Canada's unemployment rate hit 7% in May, up two percentage points since March 2023. Excluding the pandemic period, this was the highest unemployment rate since September 2016.

The UK is Edging Towards a Recession, With the EU Not Far Behind

After experiencing a technical recession in the second half of 2023, the UK appears to be entering another downturn. The Office for National Statistics estimates that Gross Domestic Product shrank by 0.3% in April, the largest contraction since October 2023. Retail sales volumes fell by 2.7% in May, far worse than the consensus expectation of a 0.5% decline.

CHART 24
There Is A Reason “BBB” Is One Notch Above Junk



* CALCULATIONS BASED ON ESTIMATES FROM "DEBT-SERVICE EFFECTS DERIVED FROM H.R.1, THE ONE BIG BEAUTIFUL ACT", CBO (JUNE 2025).
** ASSUMES THE AVERAGE INTEREST RATE ON FEDERAL DEBT IS RAISED ABOVE THE BASELINE BY A DIFFERENTIAL THAT STARTS AT 10 BASIS POINTS IN 2025 AND INCREASES BY 10 BASIS POINTS IN EACH SUBSEQUENT YEAR UNTIL IT REACHES 1% IN 2034.
SOURCE: US CONGRESSIONAL BUDGET OFFICE.

According to the Bank of England, mortgage approvals swooned in April to their lowest point in over a year. The RICS monthly house price balance dropped in May to its weakest level since July 2024; 8% more qualified surveyors estimated that home prices had fallen over the past three months than risen.

Although the UK’s version of the BLS’s household survey shows that employment has gradually increased, payroll employment (which is based on tax records) continues to fall, possibly as more workers enter the informal economy. The tax rolls show that payrolls dropped by 109K in May, the seventh consecutive monthly decline. Payroll employment is now 282K, or 0.9%, below its July 2024 peak. The job openings rate remains in a downtrend, hitting the lowest level since March 2021. The unemployment rate has edged up to a four-year high of 4.6%.

The labor market in continental Europe has shown greater resilience. Nevertheless, cracks are forming. Most notably, the job openings rate has now returned to pre-pandemic levels, suggesting that any further decline in openings will start to push up unemployment.

Trade Tensions Will Hurt the EU

EU exports to the US soared in March but have now dropped back to where they were at the start of the year. EU exports to the US are 3.2% of EU GDP, a number that has been steadily trending higher since 2010. EU companies currently face a 10% base tariff on exports to the US. The auto sector faces a 25% tariff, while steel and aluminum producers face a 50% tariff.

Increased Chinese competition has exacerbated the problems facing European exporters. China's export mix overlaps more closely with the euro area than with the US. While Chinese exports to the US plunged by 35% in May from a year earlier, they jumped by 12% to the EU.

A strengthening euro has not helped matters: EUR/CNY is up 10% since the start of the year and sits at its strongest level in 11 years. Chinese productivity has nearly doubled relative to euro area productivity over this period. According to a survey conducted by the European Commission, German companies are less competitive than at any time during the past 30 years.

Limited Scope for Stimulus Outside of Germany

German fiscal stimulus should eventually help cushion the blow from weaker exports. However, slower-than-expected implementation should limit the fiscal thrust to only 0.5% of GDP in 2025. The fiscal deficit should then rise by 1%-to-1.5% of GDP in 2026, and 1.5%-to-2% of GDP in 2027, relative to the pre-election baseline.

Other euro area economies, however, have little scope to engage in fiscal easing. France, Spain, Italy, Belgium, and Greece all have government debt-to-GDP ratios in excess of 100%. The recently passed French budget seeks to bring down the fiscal deficit from 5.8% of GDP in 2024 to 5.4% of GDP in 2025 and 4.6% of GDP in 2026.

Japan: Export Weakness Versus Domestic Resilience

Real GDP in Japan contracted by 0.2% in the first quarter. The Bloomberg consensus sees 0.1% growth in Q2. Not surprisingly, the trade war is adversely affecting Japanese exporters. Exports fell in May for the first time in eight months on a year-over-year basis, led by a steep drop in auto exports to the US. As in most other countries, Japanese vehicle exports face a 25% tariff in the US. Japan's top trade negotiator, Ryosei Akazawa, lamented last week that trade negotiations with the U.S. "remained in a fog."

In contrast, Japanese domestic demand remains sturdy. Retail sales grew 3.3% year-over-year in April, exceeding the market forecast of 3.1%. Firmer wage growth helped support the rise in spending.

A key variable going forward will be the trajectory of energy prices. Japan is entirely dependent on foreign oil and liquefied natural gas. Higher energy prices will raise business costs and depress household real incomes.

China: Trade War Shock Meets Housing Blues

China's economy has held up better than expected so far this year. This is partly because China was able to redirect its exports away from the US. It is also because fiscal policy turned more supportive. Unlike what was the case in 2024, aggregate government spending has risen more briskly this year.

Nevertheless, private-sector loan demand remains anemic. Both households and firms are still in deleveraging mode. Despite increased fiscal expenditures, the overall credit/fiscal impulse has risen only modestly.

Deflationary forces continue to exact a toll on the economy. Producer prices have fallen 9% since June 2022. Whereas export volumes are up 13% year-over-year, import volumes are down 1%.

The housing market is still extremely weak. Housing starts are down 71% from their peak, while floor space sold is down 53%. After showing tentative signs of stabilization earlier this year, home prices fell again in May.

Unless the government further steps up efforts to stimulate the economy, growth is likely to relapse. While BCA's China strategist, Jing Sima, expects policymakers to introduce additional measures in the third quarter to avoid a fiscal cliff, she is skeptical that these steps will be sufficient to generate a meaningful cyclical recovery in either the housing market or the broader economy.

II. Financial Markets

A. Global Asset Allocation

There is still a pathway to a soft landing. President Trump could further dial back tariffs in a meaningful way. If the bond market disregards the resulting loss of tariff revenue, while turning a blind eye to the prospect of even more unfunded tax cuts in the OBBBA, growth both in the US and abroad could hold up.

While we would not rule out such a benign outcome, it is not our base case. As such, our 12-month US recession probability stands at 60%, with most of the risk front-loaded in the next six months. This is below our estimate of 75% that prevailed before President Trump paused the Liberation Day tariffs, but above betting market odds of around 30%. ...

We are keenly aware that being early is nearly indistinguishable from being wrong. If the US economy does not show clear evidence that it is entering a recession over the next three months, we will have to concede that our 2025 recession call was probably wrong.

For now, we recommend that investors only modestly underweight equities in their portfolios. A more aggressive underweight will be advisable if the whites of the recession's eyes become visible. ...

B. Equities

The Stock Market is Not Pricing in a Recession

During a mild recession, the forward PE ratio for the S&P 500 usually falls into the teens. During a deep recession, it can often drop into the single digits. In that light, today's forward P/E multiple of 21.8 is not pricing in much recession risk **(Chart 39)**.

The fact that earnings are cyclically elevated does not help matters. The S&P 500 forward profit margin – calculated by dividing expected earnings by expected sales – currently stands at 13.9% **(Chart 40)**. This is three percentage points above the post-2000 average, and 1.5 points higher than in 2019.

Some commentators have argued that the growing weight of highly profitable tech companies in the index accounts for the secular rise in profit margins. While there is some truth to that, **Chart 41** underscores that profit margins are currently elevated across most US sectors, not just tech.

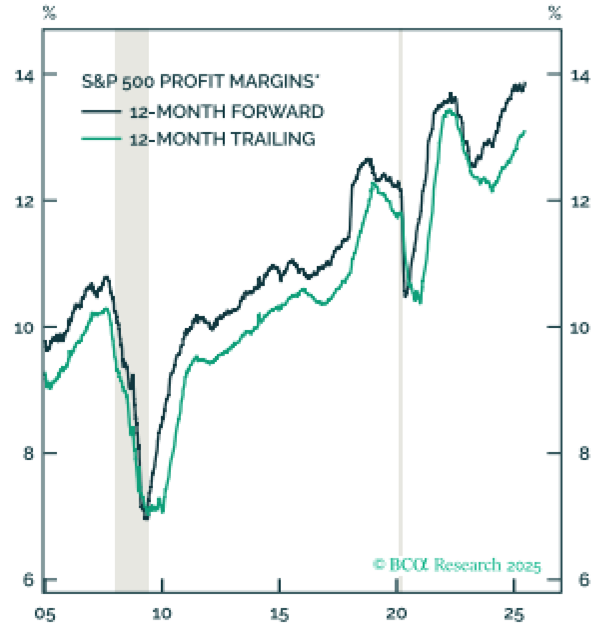
With that in mind, our recessionary target for the S&P 500 of 4500 is, if anything, quite optimistic. Earnings estimates for calendar 2025 have already fallen from $274 at the start of this year to $264 **(Chart 42)**. If the US enters a recession later this year, earnings could ultimately come in at $250, with the PE ratio dropping to 18. That would leave the S&P 500 at 4500.

In a non-recessionary scenario, the S&P 500 would likely rally to 6500. Given our recession odds of 60%, this implies a weighted-average target of 5300, 13% below current levels.

CHART 39
US Stocks Are Not Pricing In A Recession

* THE FORWARD P/E TROUGH IN OCTOBER 2002 OCCURRED AFTER THE 2001 RECESSION, DURING WHICH UNEMPLOYMENT WAS STILL RISING. SOURCE: FACTSET AND S&P GLOBAL (AS OF JUNE 2025. BCA RESEARCH CHARTS DISPLAY EARNINGS DATA FROM FACTSET INSTEAD OF REFINITIV/IBES).
NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS.

CHART 40
S&P 500 Forward Profit Margins Are Hovering At Historical Highs



* CALCULATED AS EPS / SPS.
SOURCE: FACTSET (AS OF JUNE 2025. BCA RESEARCH CHARTS DISPLAY EARNINGS DATA FROM FACTSET INSTEAD OF REFINITIV/IBES).
NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS.

Favor Defensive Equity Sectors Over Cyclicals

In view of our cautious bias, we recommend that investors overweight US defensive sectors such as consumer staples, health care, and utilities in their equity portfolios over a 12-month horizon. On the flipside, we would underweight consumer discretionary, financials, materials, industrials, and real estate. We are neutral on energy, communication services, and IT.

Our neutral stance on tech is a reflection of the various crosscurrents impacting the sector. On the one hand, we are optimistic about the long-term transformative power of AI and other emerging technologies. On the other hand, tech valuations are still elevated. Although the Magnificent 7 has cheapened since the start of the year, the group trades at 28.8-times forward earnings. In comparison, the other 493 companies in the S&P 500 trade at 19.1-times forward earnings **(Chart 43)**. Projected earnings growth for the Mag 7 is also expected to slow sharply relative to the rest of the index **(Chart 44)**.

The Longer-Term Outlook for Tech: Why AI May Not Be As Profitable As Investors Assume

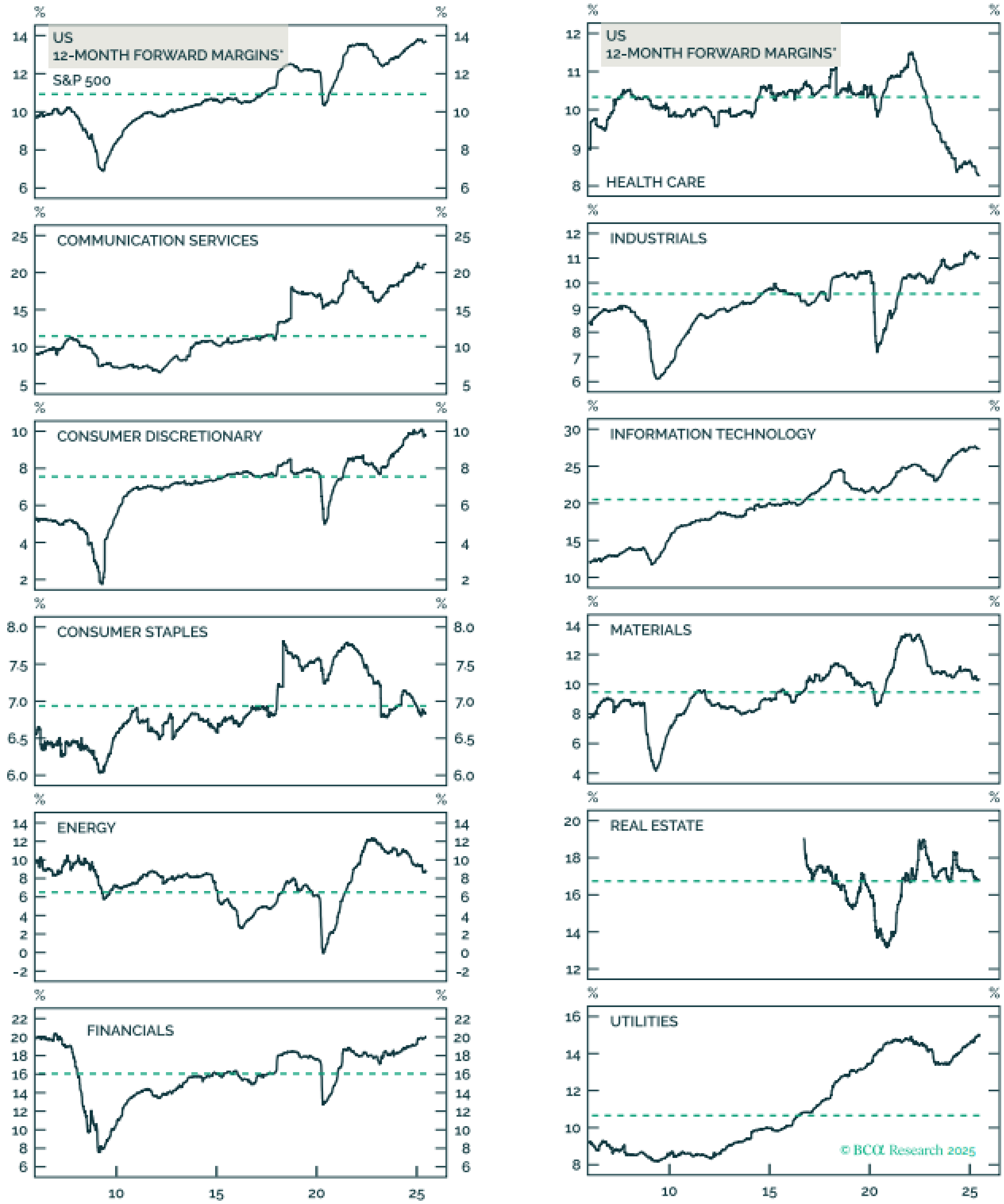
So far, the impact of AI on the economy has been fairly modest. **Chart 45** shows that output-per-hour growth is running only slightly above the pre-pandemic trendline.

As noted above, our guess is that AI will eventually lift productivity growth to a more significant degree than it has so far. However, even if it does, this may not translate into higher profits for several years.

Consider the dotcom era. The diffusion of computer networking technologies did boost US productivity in the mid-1990s. Between 1995 and 2005, productivity growth averaged about one percentage point higher than during the prior 10 years. Yet, it was not until 2005 – ironically, just as productivity growth was normalizing – that tech profits exploded.

CHART 41

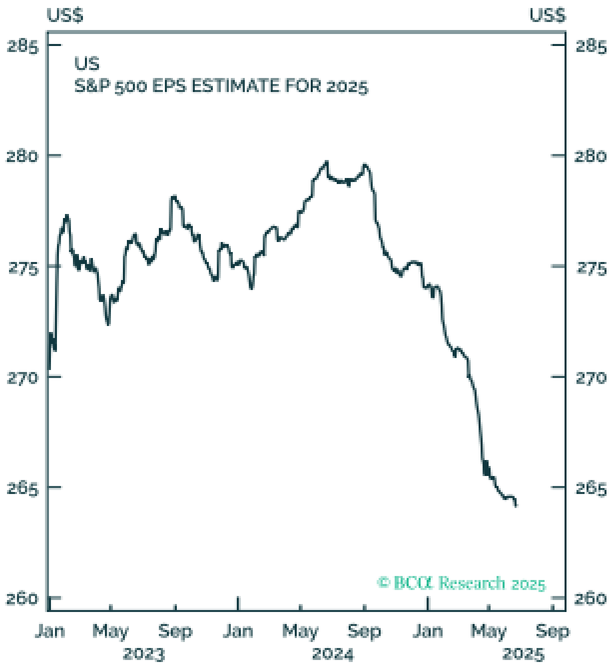
It's Not Just Tech: Profit Margins Are Currently Elevated Across Most Sectors



* CALCULATED AS EPS / SPS.
SOURCE: BLOOMBERG FINANCE L.P.
NOTE: DASHED LINES REPRESENT THE AVERAGE FROM 2012 TO 2019.

CHART 42

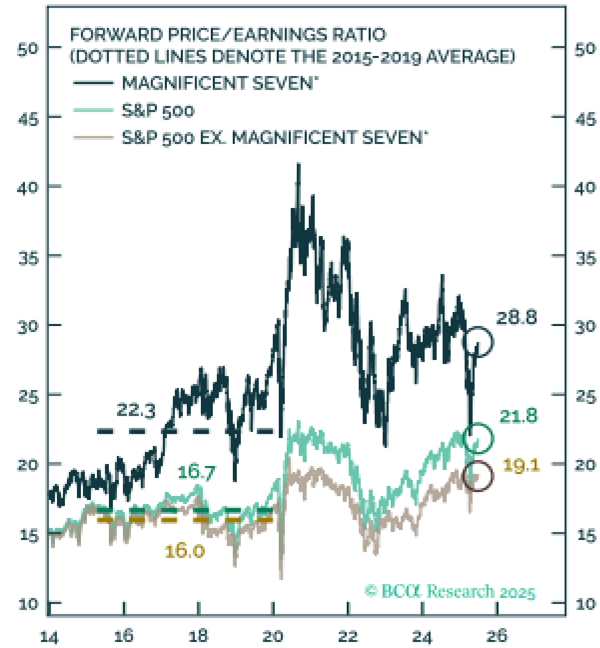
Earnings Estimates For 2025 Have Fallen



SOURCE: FACTSET (AS OF JUNE 2025, BCA RESEARCH CHARTS DISPLAY EARNINGS DATA FROM FACTSET INSTEAD OF REFINITIV/ IBES).

CHART 43

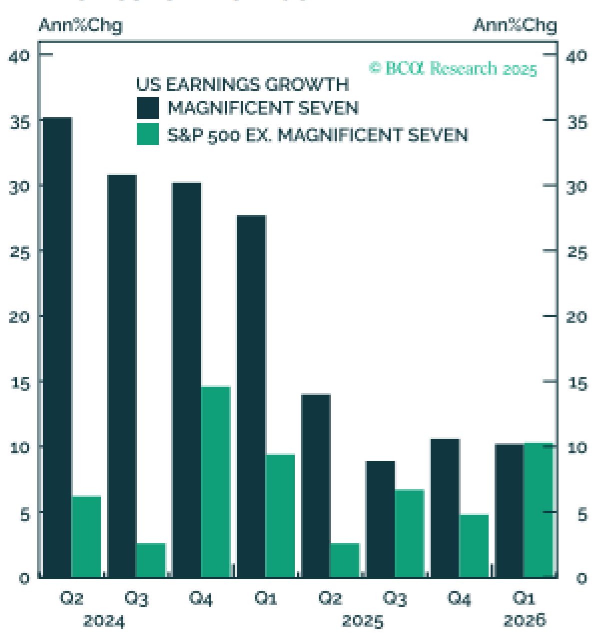
Even Outside Of The Mag7, Valuations Are Still Elevated



* INCLUDES AAPL, AMZN, GOOGL, META, MSFT, NVDA, AND TSLA.
SOURCE: FACTSET. (AS OF JUNE 2025, BCA RESEARCH CHARTS DISPLAY EARNINGS DATA FROM FACTSET INSTEAD OF REFINITIV/IBES).

CHART 44

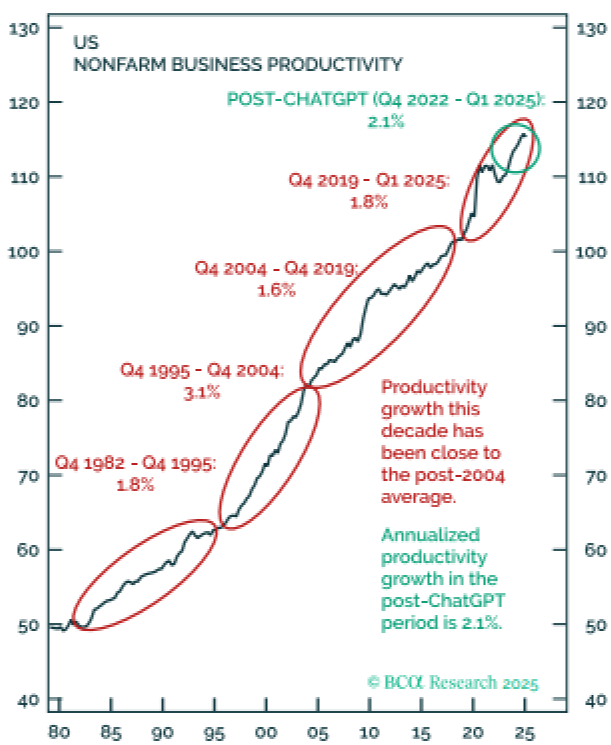
Earnings Growth For The Mag7 Is Expected To Slow Sharply Relative To The Rest Of The Index



SOURCE: FACTSET.

CHART 45

Gauging The Impact Of AI: So Far, Output-Per-Hour Growth Is Only Running Slightly Above The Pre-Pandemic Trendline



SOURCE: BUREAU OF LABOR STATISTICS (BLS).
NOTE: VALUES IN RED AND GREEN DENOTE ANNUALIZED GROWTH.

When tech companies finally did figure out how to monetize the internet, they did so by harnessing two economic forces that allowed them to create natural monopolies for their businesses: 1) network effects; and 2) economies of scale.

Network effects stem from the fact that certain technologies become increasingly attractive when more people use them. Social media platforms are a classic example: Lots of people use Facebook and Instagram because many other people use them.

Bitcoin is another example. People value Bitcoin simply because other people value Bitcoin. There is nothing special about Bitcoin's algorithm other than it was the first to come on the scene.

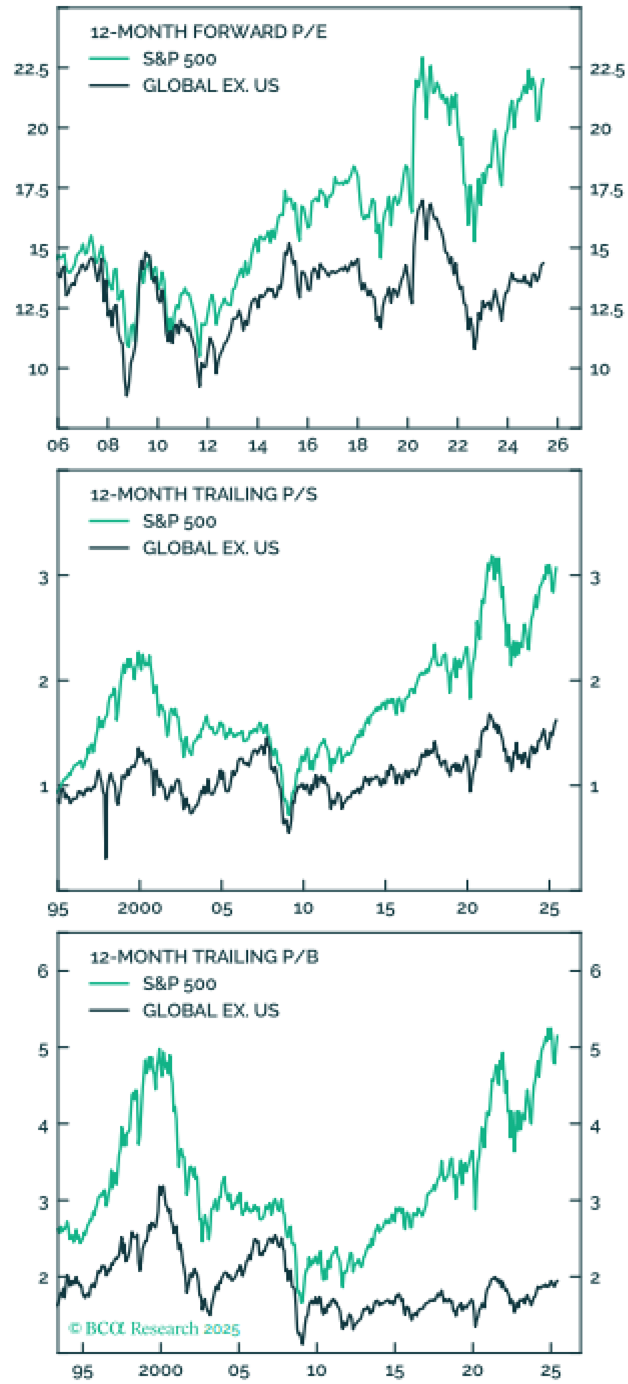
The problem for large language models is that they do not benefit from network effects to any great degree. If one uses ChatGPT, that does not make it more attractive for others to use it. On the contrary, one person's usage of an AI system typically slows things down for other users.

This brings us to the second force that sustained tech profits: economies of scale. Economies of scale occur in cases where there are high fixed costs and low marginal costs. Software is a good example: It takes a lot of money to produce a good piece of software but once the code is written, creating additional copies is almost costless.

AI is different. To add users to an AI system, one needs to build data centres, purchase expensive GPUs, and incur significant energy costs. In that respect, large language models are a lot like airlines. Airlines are indispensable for global commerce but never seem to make much money because of their high operating costs and the fact that they are largely indistinguishable from one another.

CHART 47

Non-US Stocks Are Quite Cheap Relative To US Stocks



SOURCE: BLOOMBERG FINANCE L.P.

Outlook for Non-US Stocks: Cyclical Headwinds Versus Valuation Tailwinds

Non-US stocks tend to be more cyclical than their US peers. Normally, when analysts are revising down US earnings estimates, they are also cutting estimates for non-US stocks by an even larger degree. If global growth weakens further, as we expect, this will disproportionately hurt overseas bourses.

Looking beyond the current business cycle, we see scope for non-US stocks to outperform over the remainder of the decade. NonUS stocks trade at a fairly large discount to US stocks based on price-to-earnings, priceto-sales, and price-to-book **(Chart 47)**.

European equities, in particular, should see stronger returns in the years ahead. European banks are in much better shape than they were a decade ago, which should support stocks and the broader economy. Efforts to hasten economic integration and adopt pro-market reforms should also benefit European equities. ...

C. Fixed Income

Not Quite Ready To Go Overweight Duration

BCA's US fixed-income team's "Golden Rule" says that one should overweight duration if one expects the Fed to cut rates over the next 12 months by more than what the market is discounting. At present, the market is discounting 120 bps of rate cuts. In our baseline recessionary scenario, we would expect the Fed to bring rates down by 225 bps to 2% over the next 12 months. Even in a non-recessionary scenario, we would expect the Fed to cut rates one or two times, given that the inflation shock from higher tariffs is likely to be temporary.

By this logic, one should be overweight duration. Yet, as of now, we are only neutral on duration. The main reason is fiscal policy. The prospective tsunami of debt issuance over the coming years will likely keep a floor under yields. Indeed, higher yields may be the only disciplinary tool to prevent a further widening in the structural budget deficit.

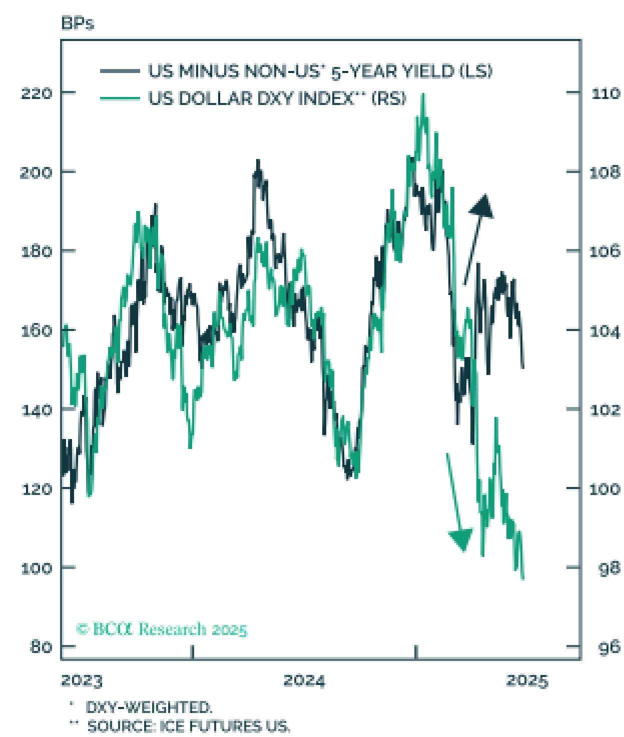
To be sure, Treasury yields would probably still fall temporarily once the whites of the recession's eyes become visible. Thus, we would likely go long duration tactically if more evidence surfaced in favor of our base case recessionary scenario. Until then, we prefer to stay on the sidelines. ...

D. Currencies

US Dollar Pricing In Less Exceptionalism

The US dollar usually tracks the path of interest rate differentials **(Chart 57)**. When US rates rise relative to overseas rates, the dollar normally strengthens, and vice versa. Since Liberation Day, however, this relationship has broken down. Even though 5-year rate differentials have moved 12 bps in the dollar's favor, the DXY index has still weakened by 5.9%.

CHART 57
The US Dollar Has Been Trading Like An EM Currency



Decreased foreign demand for US bonds has contributed to the weakening dollar. Treasury International Capital (TIC) records show net foreign selling of US Treasury notes and bonds in April, the last month for which data is available. The largest amount of selling emanated from China and Belgium. The latter is home to Euroclear and captures custodial Chinese holdings.

We expect that foreigners will continue to express their revulsion to President Trump's trade policies by reducing exposure to US dollar-denominated assets. That said, the US dollar is typically a countercyclical currency. If global growth weakens, the dollar is likely to stabilize and possibly even strengthen modestly over the next few quarters.

Over a structural horizon, we expect the dollar to resume its weakening trend after the recession ends. **Chart 59** highlights that the dollar is still 17% overvalued based on its Purchasing Power Parity (PPP) exchange rate – the exchange rate that equalizes the price of a representative basket of goods and services across countries. Historically, the dollar's value relative to PPP has been an excellent predictor of its future 10-year return. ...

E. Commodities

Well, That Deescalated Quickly

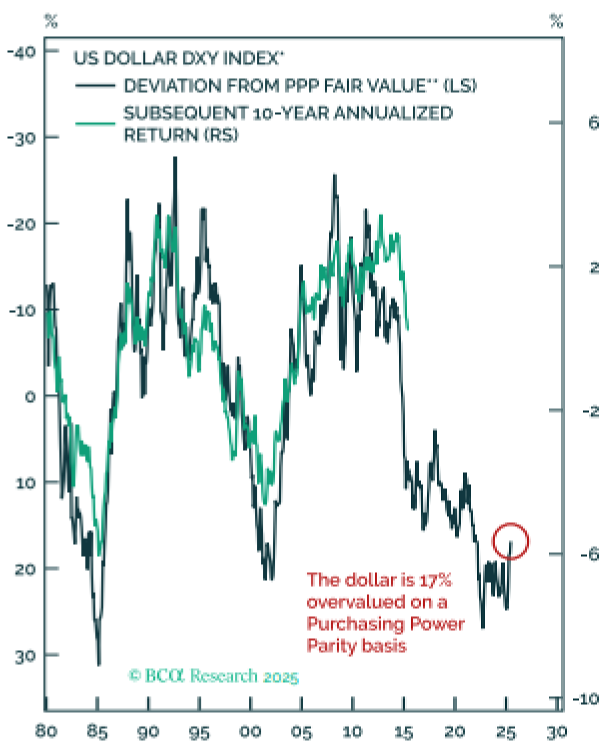
In writing this report, our intention was to leave the section on oil for last. In retrospect, that was a smart decision, given that we went from the spectre of all-out war in the Middle East to chants of Kumbaya over the course of a single weekend.

BCA's geopolitical team is skeptical that a lasting peace in the Middle East has been achieved. Nevertheless, the immediate risk of a major oil shock has been neutralized.

Looking out, the trajectory of the global economy will be the main driver of oil prices. If global growth weakens, oil prices will fall further. In a recessionary scenario, Brent will drop to about $50/bbl. That said, we doubt that Brent will sink much below that level. The current breakeven price of US shale producers is $65/bbl **(Chart 62)**. As it is, the US rig count has fallen 5% since last November's presidential election. Any major lasting decline in oil prices will take too much US production offline, causing prices to go back up. ...

CHART 59

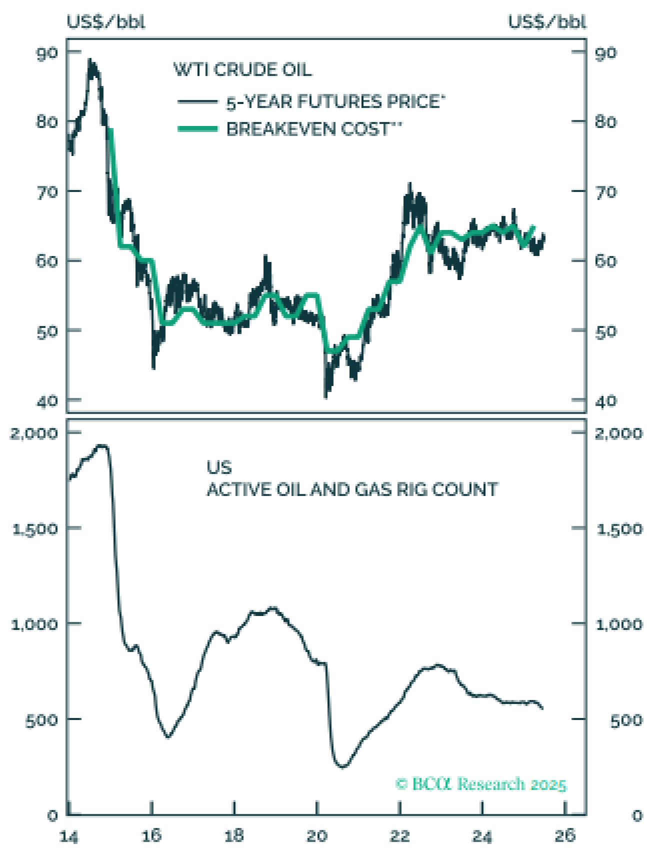
The USD Remains Overvalued



* SOURCE: ICE FUTURES US.
** BCA PURCHASING POWER PARITY MODEL BASED ON ADJUSTED CPI. PLEASE REFER TO THE FOREIGN EXCHANGE STRATEGY JANUARY 20, 2023 SPECIAL REPORT TITLED "CURRENCY VALUATION AND LONG-TERM RETURNS: PART 1," FOR FURTHER DETAILS.

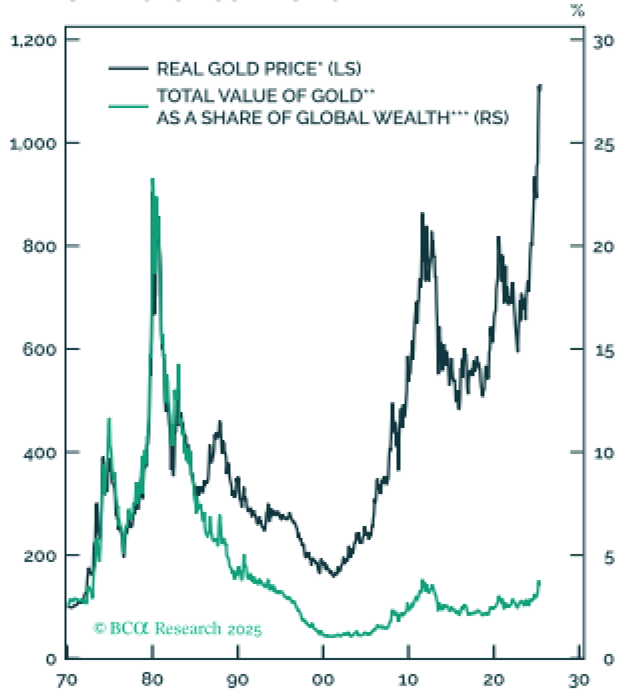
CHART 62

Oil Prices Have Downside, But It Is Limited



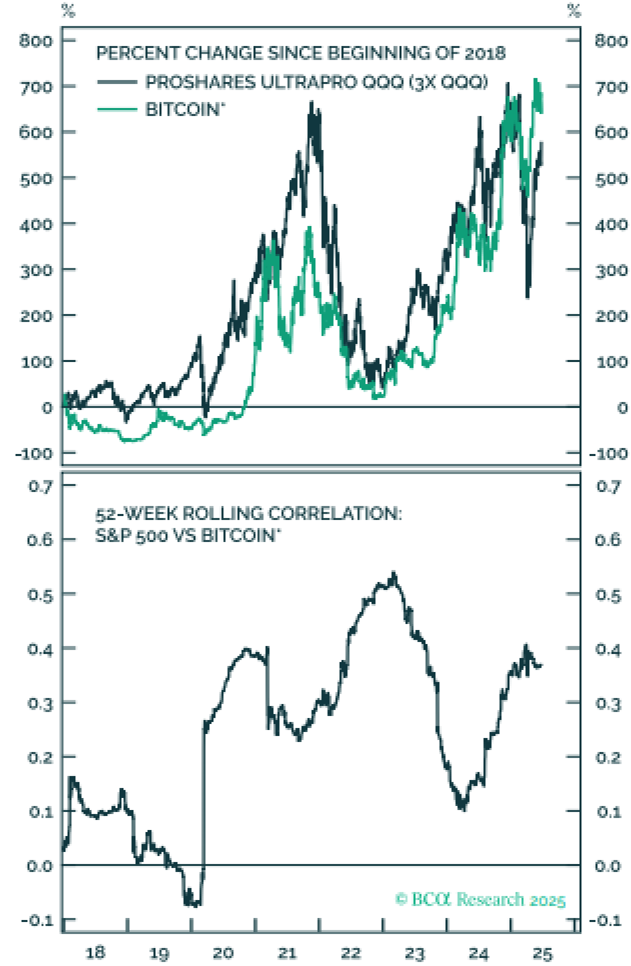
* SOURCE: CHICAGO MERCANTILE EXCHANGE (CME).
** SOURCE: FEDERAL RESERVE BANK OF KANSAS CITY. FIRMS WERE ASKED WHAT OIL AND NATURAL GAS PRICES WERE NEEDED ON AVERAGE FOR DRILLING TO BE PROFITABLE ACROSS THE FIELDS IN WHICH THEY ARE ACTIVE.

CHART 65
Gold Prices Are Near Record Highs But Still Have Room To Run



* DEFLATED BY HEADLINE CPI, IN MAY 2025 US DOLLARS.
** GOLD PRICE MULTIPLIED BY TOTAL STOCK OF GOLD SUPPLY. SOURCE: METALS FOCUS, WORLD GOLD COUNCIL, US GEOLOGICAL SURVEY, AND BCA CALCULATIONS. SERIES REBASED TO JAN 1970 = 100.
*** SOURCE: CREDIT SUISSE, MSCI INC. (SEE COPYRIGHT DECLARATION), OECD, AND BCA CALCULATIONS.

CHART 67
Bitcoin Remains Highly Correlated With The Stock Market



* US DOLLAR TO BITCOIN. SOURCE: MACROBOND FINANCIAL AB.

Favor Gold Over Bitcoin

In real terms, the price of gold has returned to its 1980 peak. While some might argue that this is a sign that gold is overvalued, we would contend that the real price of precious metals should trend higher over time, in line with the overall trend in global wealth. By that measure, gold prices still have upside **(Chart 65)**.

Concerns about government solvency in the major economies are not going away anytime soon. Nor will lingering worries about the US dollar's role as a reserve currency. The share of gold in China's foreign-exchange reserves has increased from 1% in 2008 to around 7%. That fraction is likely to keep rising. As a whole, central banks will continue to buy gold at twice the pre-pandemic pace.

Bitcoin is a tougher call. Our bearish view on the cryptocurrency clearly has not panned out. For better or for worse, the demand for easily concealable and easily transferable wealth remains strong. That said, Bitcoin is still highly correlated to the stock market **(Chart 67)**. (HCM continues to view Bitcoin as a speculative vehicle, not an asset.) If the S&P 500 declines over the coming months, the price of Bitcoin will fall.