

# VIEWPOINTS

JULY 2025

## Geopolitics, Debt & Deficits, and the Tech Supercycle

In today's dynamic financial landscape, three major themes interplay to shape market movements: Geopolitics, Debt & Deficits, and The Tech Supercycle. These forces are intricately connected, influencing investor sentiment and global economic trends.

**Geopolitics:** We are navigating an environment characterized by a multipolar world. Territorial disputes and fears surrounding nuclear rearmament persist, presenting significant challenges to global stability.

The uncertainty creates powerful investment implications. It is likely to lead to increased spending on military capabilities around the globe. In addition, the risk premium in commodity markets is likely to be volatile and investors should be prepared for potential supply disruptions.

**Debt & Deficits:** The last few years have witnessed an uptrend in government debt worldwide, primarily driven by fiscal support measures implemented in response to the COVID pandemic. Over the next five years, fiscal trends are poised to diverge notably. The U.S. is likely to maintain substantial deficit of around 5-7% to bolster a new wave of tax cuts. Other parts of the developed world are on a more decisive path of fiscal consolidation.

**The Tech Supercycle:** Artificial Intelligence (AI) has transitioned from being a mere tool to a foundational layer across numerous sectors. This transformation is reinforced by the rapid expansion of digital infrastructure, including 5G, cloud computing, and the establishment of additional data centers (global data center demand is expected to grow by a 15% 1CAGR to 152 gigawatts in 2030 — Royal Bank of Canada). These trends appear sustainable and robust, exhibiting resilience against short-term economic volatility.

The recent earnings season highlighted firms' confidence in AI-driven growth and resilient cloud performance.

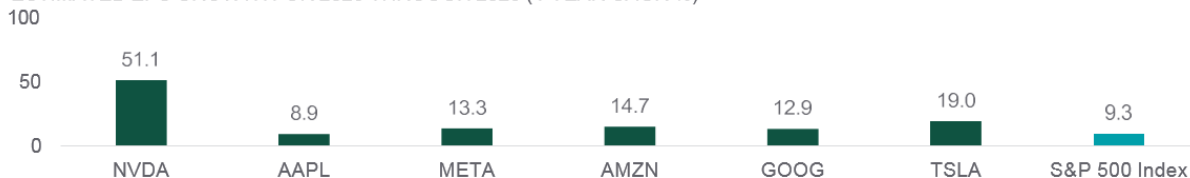
Companies are aggressively pursuing capital returns, reflecting their optimism in leveraging technological advancements to drive future profitability.

**Conclusion:** These themes are interconnected, and have the potential to cause significant deviations in market outcomes depending on their results. While event volatility is an omnipresent factor in markets, and can currently be found in both FX and Fixed Income markets; it is less apparent in equity markets. Leading us to be more cautious than usual in our equity market positioning.

### Tech Earnings Support

Despite increased inflation and decreased growth expectations, U.S. stocks have retraced losses.

ESTIMATED EPS GROWTH FOR 2025 THROUGH 2028 (4-YEAR CAGR %)



Source: Northern Trust Asset Management, Bloomberg. Annual estimates for 2025-2028 as of 6/17/2025. NVDA = Nvidia. AAPL = Apple. AMZN = Amazon. GOOG = Google. TSLA = Tesla. META = Meta Platforms. Historical trends are not predictive of future results. EPS = earnings per share. 1CAGR = compounded annual growth rate.

## Interest Rates

**How have U.S. Treasury auction results been?** While a handful of U.S. Treasury auction results drew attention in April, we haven't seen a widespread shift in demand across the curve in recent auctions. T-Bills in particular have seen solid demand as net supply is currently negative. Precisely determining "foreign demand" in real time is quite difficult, but, on the whole, investor demand doesn't appear to have shifted as definitively as some press reports may lead you to believe.

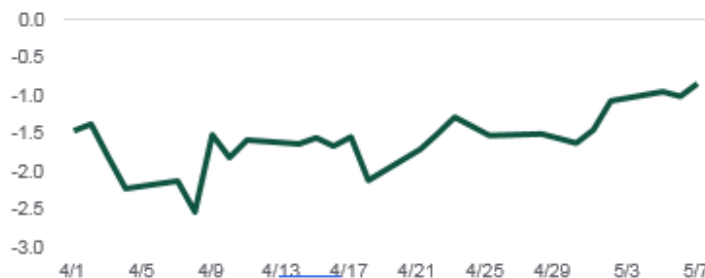
**Are there any signs that investors are changing their allocations to cash assets like 1MMFs?** MMF assets at the industry level have been growing this year, albeit at a slower pace than the strong run up seen during the prior 2 years. Instead of a shift in cash allocations, which largely held steady even during April of this year, perhaps we're seeing cash allocations being maintained around all-time highs as measured by industry assets under management.

**Are there potential policy changes on the horizon that you're watching?** Details around the implementation of central clearing of U.S. Treasuries, potential design changes of the Standing Repo Facility, as well as potential changes to the Supplementary Leverage Ratio.

## U.S. BILL NET SUPPLY HAS BEEN NEGATIVE RECENTLY

U.S. bills outstanding have fallen since the start of 2025.

# OF RATE CUTS EXPECTED BY JULY 2025



Source: Northern Trust Asset Management, Bloomberg. Data from 1/31/2023 to 6/10/2025. 1MMFs = Money Market Funds. Historical trends are not predictive of future results.

- Despite some attention-grabbing Treasury auctions in April, overall demand — especially for T-Bills — remains solid, with no broad signs of investor fatigue.
- Cash allocations like money market funds continue to grow, though more gradually, suggesting investors are maintaining high cash levels rather than reallocating.
- We're closely monitoring potential policy shifts that could reshape Treasury market dynamics such as central clearing, repo facility tweaks, and leverage ratio changes.

## Credit Markets

High yield (HY) saw solid performance last month with the strongest monthly spread performance since 2023. Despite some volatility in the rates market, HY spread tightening offset negative impacts from duration, resulting in attractive absolute returns. As trade tensions eased, capital markets activity resumed. In May, \$32 billion of HY gross issuance represented substantial increases in monthly volume from the tariff-induced market slowdown in April.

While HY supply was elevated last month, technicals continued to be favorable with HY producing its 5th consecutive supply deficit year-to-date due to continued strong organic inflows. Year-to-date, Calls (\$55.5bn), Tenders (\$11.3bn), and Maturities (\$21.3bn) totaling

\$88.1bn compare to \$105.8bn of gross new-issuance year-to-date. Meanwhile, coupon reinvestment (\$28.5bn, assuming a 75% reinvestment rate) and retail inflows (+\$1.8bn) total \$30.3bn. With Fallen Angels exceeding Rising Stars by \$10.8bn, the high-yield bond market has produced a supply deficit of -\$1.4bn in 2025 year-to-date following four consecutive years of supply deficits (-\$496bn aggregated).

## HY SUPPLY AND DEMAND IMBALANCE

High yield saw solid performance last month with the strongest monthly spread performance since 2023.

HY SUPPLY SURPLUS / (SHORTFALL, \$B)



Source: Northern Trust Asset Management, J.P. Morgan. Data as of 5/28/2025. HY = High yield. Historical trends are not predictive of future results.

- In May, \$32 billion of gross issuance priced in the high yield bond market representing substantial increases in monthly volume from the tariff-induced market slowdown in April.
- While high yield supply was elevated last month, technicals continued to be favorable with high yield producing its 5th consecutive supply deficit year-to-date due to continued strong organic inflows.
- The high-yield bond market has produced a supply deficit of -\$1.4 billion in 2025 year-to-date.

## Equities

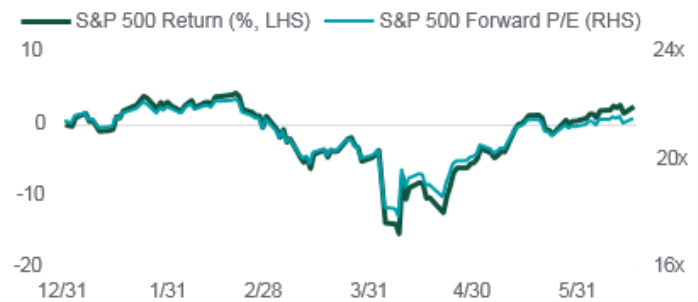
Across 2025 year-to-date – global equities are up 7% with notable separation between U.S. equities (+2%) and strong gains (in dollar terms) in both non-U.S. developed (+18%) and emerging market equities (+12%). U.S. equities have gained back a little ground over the last month with some help from the resurgence in megacap tech. Cyclical areas of the market performed better than defensive areas over this stretch. Non-U.S. equity returns continue to benefit from decent performance in local currency terms plus currency impacts from US dollar depreciation.

The S&P 500 P/E ratio widened back out to a little under 22x, above 2024 year-end and not far below February’s peak, reflecting reduced fear of meaningful disruption from trade policy. There continues to be a bifurcation between Megacap tech and non-megacap tech earnings contributions. Some of the potential tariff headwinds that are not embedded in company guidance skews risk to the downside in earnings expectations. Although the tech rally could continue to support U.S. equities, we do not believe it is a good environment to take a sizable position in either direction. Instead, we prefer non-U.S. developed equities within our equity allocation.

## VALUATIONS HAVE BOUNCED BACK

S&P 500 P/E widened above 2024 year-end levels.

### 2025 S&P 500 RETURNS AND VALUATION



Source: Northern Trust Asset Management, Bloomberg, FactSet. S&P 500 Index. P/E = Price-to-earnings ratio. Data is from 12/31/2024 through 6/16/2025. Past performance is not indicative or a guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index. Historical trends are not predictive of future results.

- U.S. equities have performed well over the last month with some help from the resurgence in megacap tech.
- The S&P 500 P/E widened back out to a little under 22x, which is above 2024 year-end levels.
- Although the tech rally could continue to support the
- U.S. market, we do not believe it is a good environment to take a sizable position in either direction.

## Positioning Scenarios

### Supply Restraint (40% probability)

Supply-side shocks from higher tariffs in addition to broader policy uncertainty weigh on consumer and corporate activity while halting the disinflationary process until a recession takes shape.

### Soft Landing (35% probability)

Global growth slows but remains positive via two potential paths: 1.) tariff policy eases; 2.) the U.S. economy is more resilient than expected and avoids a major deterioration in the consumer backdrop.

### Stagflation (10% probability)

Initially similar to the Supply Restraint scenario, but the rise in inflation is more persistent. As a result of slower monetary policy support, the recession is deeper and longer.

### Reflation (15% probability)

Policies of the U.S. administration have a net stimulative effect, leading to above-trend growth, persistent inflation and a pause in the Fed rate-cutting cycle.

Indexes Used and Definitions:

**MSCI ACWI:** A free-float weighted equity index that includes both emerging and developed world markets.

**S&P 500 Index:** Widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

**S&P Global Infrastructure Index:** The S&P Global Infrastructure Index includes exposure to 75 companies from around the world tha represent the listed infrastructure universe.

INVESTMENT PROCESS

The asset allocation process develops both long-term (strategic) and shorter-term (tactical) recommendations. The strategic returns are developed using five-year risk, return and correlation projections to generate the highest expected return for a given level of risk. The objective of the tactical recommendations is to highlight investment opportunities during the next 12 months where the Investment Policy Committee sees either increased opportunity or risk.

The asset allocation recommendations are developed through the Tactical Asset Allocation, Capital Markets Assumptions and Investment Policy Committees.

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