VIEWPOINTS

JUNE 2025

Tariff U-Turn; Lingering Doubts

The financial landscape is in a state of flux. Not long ago, the announcement of large tariffs sent shockwaves through global markets. As the aftershocks rippled out, policymakers scrambled to craft responses, only to eventually backtrack on their initial moves in a bid to curb unintended consequences. The latest example is the large reduction in the reciprocal tariff rates that effectively brought trade between the U.S. and China to a halt.

Similar to trade deals announced with other nations, we are witnessing the emergence of a "90-day pause." This is not just a pause; it's a strategic time-out where markets, governments, and investors are stepping back to reassess the broader implications created by the last few weeks of intense policy uncertainty. Amid this pause, investors are digesting economic data, rethinking long-held strategies, and attempting to chart a new course in an environment where quick tactical moves have proven risky.

A pivotal point in current market sentiment revolves around assets tied to U.S. growth. Over the past years, these assets—encompassing high-flying equity sectors like technology and consumer discretionary, as well as credit markets and the U.S. dollar—have significantly outperformed. However, despite their promise of superior growth, they are relatively expensive by many fundamental metrics. In times of market stress, these overvaluations have shown that such assets do not offer the cushion of safety that investors might expect. The lofty valuations of U.S. growth assets, built on future potential, rather than current stability, mean that during a downturn, they tend to falter rather than act as a safety net. This reality is prompting both institutional and individual investors to re-examine allocation strategies in search of true defensive assets that can withstand turbulent periods.

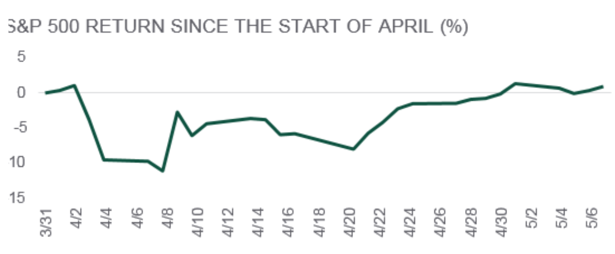
Complicating the picture further is the difficulty in interpreting fresh economic data. The mix of conflicting signals—whether from trade imbalances, sharp falls in consumer and business confidence, or fluctuating currency values—adds layers of uncertainty. In this context, the 90-day pause is being seen as an opportunity to take a hard look at these mixed messages before making any decisive moves.

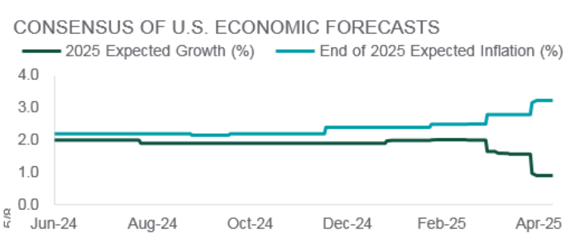
An undercurrent of optimism permeates financial markets. Even amid the caution, some investors are betting that these pauses will set the stage for a robust rebound. As we navigate choppy waters, this phase of waiting invites us to reflect on the balance between risk and reward. It's a reminder that markets are cyclical, and sometimes the smartest move is to pause, analyze, and then pivot.

While the glow of U.S. growth remains alluring, investors are reminded that such assets, when priced too high, may not provide the returns they once did. By carefully weighing both the promise and the peril, market participants can craft strategies that endure beyond the current uncertainty. Hence, we are proponents of a more diversified and valuation-sensitive investment approach, and this perspective makes us less enthusiastic about adding growth-sensitive exposure in U.S. assets after the recent rebound in markets.

Stocks bounced back, but macro projections did not

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





Source: Northern Trust Asset Management, Bloomberg. Left panel: data from 3/31/2025 to 5/8/2025. Right panel: data from 6/30/2024 to 5/8/2025. Expected growth is the percent change from the same quarter in the prior year (fourth quarter); expected inflation is average level of the year-over-year change in core Personal Consumption Expenditures inflation across the last three months of 2025.

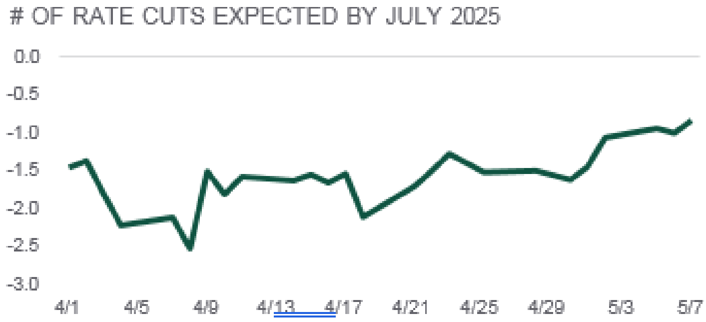
Interest Rates

We took the main message from the May FOMC meeting to be that, while uncertainty around the near-term path for the economy has increased further –so have the risks to both sides of the Fed's dual mandate – the Committee views its monetary policy as being well positioned to wait for clarity on the direction of the economy. Overall, the Chair's press conference conveyed a message that the Committee believes that, "the current stance of monetary policy leaves them well positioned to respond in a timely way to potential economic developments". The Chair went on to repeatedly emphasize that, "We [the FOMC] don't think we need to be in a hurry. We think we can be patient."

Markets have been volatile since the March FOMC meeting, especially in early April. Fed Funds Futures at one point implied 25-basis-point (bp) cuts at both the June and July FOMC meetings; which we viewed as overly aggressive. Yields on U.S. Treasuries were little changed on May 7th following the FOMC statement and the Chair's press conference, while equity markets trimmed earlier intraday gains. The futures-implied number of further rate cuts over the next twelve months remained at four 25-bp cuts – a bit more dovish than our view.

INCREASED RISKS ACROSS THE DUAL MANDATE

Uncertainty and risks have increased, but the Fed views its monetary policy well positioned to hold pat.



Source: Northern Trust Asset Management, Bloomberg. Market expectations implied by futures. Data from 4/1/2025 to 5/7/2025. Historical trends are not predictive of future results.

- The FOMC left policy unchanged in May, as widely expected.
- While risks have increased on both sides of the dual mandate, the FOMC does not think it needs to be in a hurry.
- Uncertainty has undoubtedly remained elevated. However, we view current rates as not too far off fair value and are therefore neutral duration across the fixed income portfolios we manage.

Credit Markets

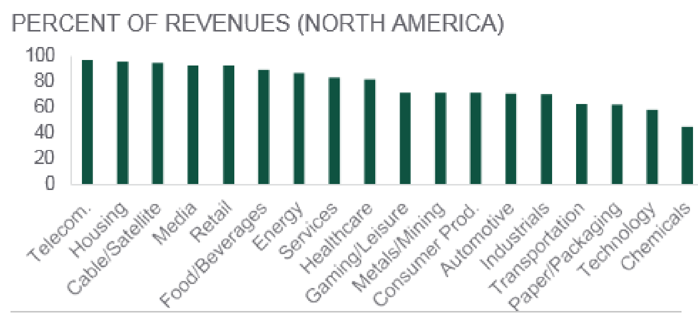
The market saw a historic increase in volatility during the month with the unveiling of potential reciprocal tariffs in early April, and accompanying recession fears. The CBOE VIX Index reached a high of 52 on April 8th, its highest closing reading since the COVID crisis in March 2020, before falling in subsequent weeks as daily news flow indicated a potential de-escalation of trade tensions. Credit markets showed remarkable resilience during this period of pronounced volatility. High yield spreads gapped higher to levels not seen since 2023, before eventually retracing. With returns ending the month flat, supported by the help of a rates tailwind. In line with the increase in volatility, sector dispersion increased materially in April as well.

Despite elevated trade tensions, U.S. high yield is relatively insulated with a majority of revenues coming from North America. Approximately 78% of revenues among

U.S. high yield issuers is generated in North America. With the notable increase in uncertainty and dispersion, this creates opportunity for active management to position for these possible tariff scenarios.

HIGH YIELD REVENUES BY INDUSTRY

U.S. high yield is relatively insulated from trade tensions as a majority of revenues come from North America.



Source: Northern Trust Asset Management, J.P. Morgan. Data as of 4/17/2025. Historical trends are not predictive of future results.

- In line with the increase in volatility, sector dispersion increased materially in April.
- High yield revenues for U.S. issuers is approximately 78% generated in North America vs. 22% international.
- Within high yield, sectors with the highest percentage of revenues generated in North America are Telecom, Housing, and Cable/Satellite, and sectors with the lowest being Paper/Packaging, Technology, and Chemicals.

Equity

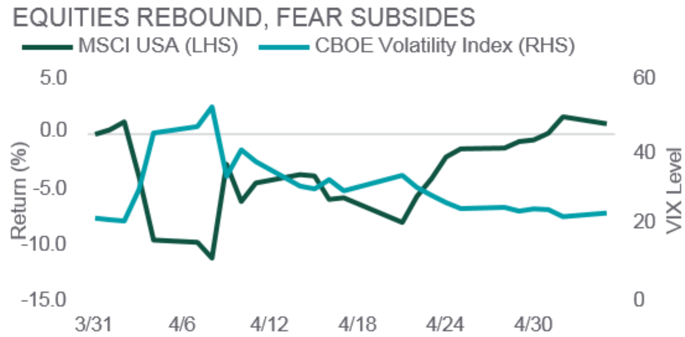
The steep drawdown following the April 2nd "Liberation Day" tariffs proved short lived. On April 9th President Trump announced a 90-day pause that sent U.S. large caps soaring nearly 10% on the day. With an additional 10.4% gained during a 9-session win streak from April 21st through May 2nd. Information Technology and technology-adjacent stocks were the best performers. Energy was a notable laggard with a weakening global outlook and OPEC+ announcing a supply increase. Health Care also lagged on tariff concerns. Outside the U.S., markets followed a similar return trajectory. U.S. investors in overseas markets benefited significantly from dollar weakness.

With over 80% of U.S. large caps reporting, Q1 2025 earnings have surprised to the upside and posted a robust 13.3% growth in earnings per share (EPS) vs. Q1 2024. Looking forward, estimates for the rest of the year have come down substantially since the start of the year, and may continue trending down.

Following the recent rally and with uncertainty around U.S. growth, we decided to decrease our allocation to U.S. Equities. Although there are positive potential catalysts, such as trade progress, deregulation, and potential tax deal, the risks are skewed to the downside.

EASY GO, EASY COME

Volatility has waxed and waned.



Source: Northern Trust Asset Management, MSCI, CBOE. Data is from 3/31/2025 through 5/6/2025. 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.

- A historic sell-off and recovery saw its inverted reflection in the Volatility Index (VIX).
- Earnings growth has been robust in Q1 but is expected to come down for the rest of the year.
- We reduced equity exposure based on a holistic assessment of a number of variables that pointed to risk being skewed to the downside.

Positioning Scenarios

Supply Restraint (45% 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.

Stagflation (15% 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.

Risk Case Scenarios

Soft Landing (35% probability)

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

Reflation (10% probability)

Policies of the U.S. administration have a net simulative 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.

Past performance is no guarantee of future results. Returns of the indexes also do not typically reflect the deduction of investment management fees, trading costs or other expenses. It is not possible to invest directly in an index. Indexes are the property of their respective owners, all rights reserved. This newsletter is provided for informational purposes only and does not constitute an offer or solicitation to purchase or sell any security or commodity. Any opinions expressed herein are subject to change at any time without notice. Information has been obtained from sources believed to be reliable, but its accuracy and interpretation are not guaranteed.

Northern Trust Asset Management comprises Northern Trust Investments, Inc., Northern Trust Global Investments Limited, Northern Trust Global Investments Japan, K.K., NT Global Advisors, Inc. and investment personnel of The Northern Trust Company of Hong Kong Limited and The Northern Trust Company.

This commentary is for our clients' general information. It does not take into account the particular investment objectives, financial situation, or needs of individual clients and does not contain investment recommendations. It is not an offer or solicitation to buy or sell any securities or to adopt any investment strategy. The information and opinions contained in this material are derived from proprietary and non-proprietary sources deemed by the Bank to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. Investment involves risks. International investing involves additional risks, including risks related to foreign currency, limited liquidity, less government regulation and the possibility of substantial volatility due to adverse political, economic or other developments. Index performance is shown for illustrative purposes only. The opinions are those of the Bank's Global Wealth Management division and are made as of the date of this commentary, and are subject to change without notice. There is no guarantee these opinions will come to pass. Other affiliates and Bank divisions may have opinions that are different from and/or inconsistent with the views expressed herein.

Investment Products:

Are Not FDIC Insured	Are Not Bank Deposits	Are Not Bank Guaranteed
Are Not Insured by Any Federal Government Agency		May Lose Value

Powered by

NORTHERN TRUST