

MARKET & ECONOMIC OUTLOOK
Insights from Multi-Asset Solutions' Portfolio ManagersQuarter ending
JUNE | 2025On the
Radar Screen

- 1. The July 9th reinstatement date for suspended tariffs looms large.** Without progress on trade negotiations, the return of reciprocal levies could reignite market volatility and lift import prices at a sensitive juncture for inflation expectations.
- 2. The reconciliation bill, likely to pass in some form,** will extend individual tax cuts and raise the debt ceiling—potentially unleashing a wave of new Treasury issuance that could test investor appetite for duration.
- 3. Escalation in the Iran-Israel conflict raises the risk of broader regional instability** and a potential shock to global energy markets. Oil prices have been rangebound, but that could change quickly if supply chains are disrupted.
- 4. With tariff-related pricing pressures building** and immigration policy curtailing labor supply, the risk of a summer reacceleration in inflation should not be underestimated. The Fed may yet find itself back in a reactive stance.
- 5. As earnings season kicks off, investor focus will center on mega cap tech.** Can these firms continue to deliver against lofty expectations, or will stretched valuations begin to buckle under the weight of reality?

“Volatility is a welcome creator of opportunity.”
– Seth Klarman

Policy Reversals and Market Rebounds

The second quarter delivered a volatile mix of policy shifts, geopolitical tensions, and economic uncertainty. Early losses in equity markets were driven by new tariffs and escalating trade tensions with Canada and Mexico. The administration's abrupt “Liberation Day” tariffs in April sent the S&P 500 down nearly 20%.

Markets rebounded sharply when the administration paused key tariff components, sparking hopes of negotiation. By quarter-end, indices had recovered their prior highs, despite lingering macro risks.

Dissonance Between Fundamentals and Price Action

The rebound came amid troubling fundamentals. Business sentiment dropped, jobless claims rose, and the housing market remained stagnant. Meanwhile, deficits are poised to widen with a new fiscal package, and global conflicts—particularly in the Middle East—continued to escalate. The administration's fiscal agenda—dubbed the “one, big, beautiful bill”—advanced in Congress, promising near-term tax relief and spending incentives, but at the cost of significantly worsening an already bloated federal deficit.

Despite these pressures, investors priced in a best-case scenario: trade peace, fiscal stimulus, solid consumer spending, and stable inflation. We remain cautious. With valuations stretched and policy risks high, volatility is likely to persist. That volatility, however, may offer long-term opportunity. We remain neutral at the asset class level, but ready to adjust tactically.

AI Optimism vs. Productivity Reality

***“You can see the computer age everywhere but in the productivity statistics.”
– Solow’s Paradox.***

AI enthusiasm remains high, yet tangible productivity gains are elusive. Like the early days of computing, the integration of generative AI is still nascent, mostly confined to experimentation rather than full-scale transformation.

It’s hard to ignore the headlines. The launch of ChatGPT in late 2022 lit the fuse on what has become a white-hot investment theme, with companies from every corner of the economy pouring capital into generative AI tools, infrastructure, and integration. Market enthusiasm has been unrelenting, particularly toward those firms seen as the architects—or at least beneficiaries—of this technological revolution. And yet, for all the buzz and billions deployed, there remains a curious absence: a clear, measurable uptick in productivity.

This isn’t a new phenomenon. In fact, it’s textbook Solow. Back in the 1980s, economist Robert Solow observed that the transformative potential of computers hadn’t yet shown up in the productivity data—despite growing adoption and investment. It took years, arguably decades, for the full economic impact of the IT revolution to materialize. That same pattern may be repeating itself. Today’s AI models are undeniably powerful, but their diffusion into workflows and operating models—particularly outside of tech-forward firms—is still in its early innings. Integrating AI at scale requires time, retraining, reengineering, and trust. Until then, most of what we’re seeing may be best described as cost center experimentation rather than enterprise-wide transformation.

While productivity gains may eventually materialize, they are unlikely to match the near-term growth expectations priced into equities. The benefits may accrue unevenly—favoring capital over labor and large firms over small—with implications for inequality, wages, and policy.

We continue to monitor the evolution of AI closely, with a grounded view: near-term hype may overestimate its impact, but long-term potential remains underappreciated.

Debt, Deficits, and the Rates Market

“We must not let our rulers load us with perpetual debt.” – Thomas Jefferson

The reconciliation bill promises tax relief and spending, but at the cost of a ballooning deficit. With the debt ceiling poised to rise and a surge in Treasury issuance expected, investors may balk at low real yields—especially if inflation proves sticky.

Tariffs and immigration restrictions risk raising input costs and limiting labor supply, potentially reigniting inflation. A spike in yields could strain federal budgets, corporate borrowing, and equity valuations.

We maintain duration near benchmark but favor modest underweights and emphasize quality in credit. If rates volatility rises, we’re prepared to act—deliberately, not reactively.

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