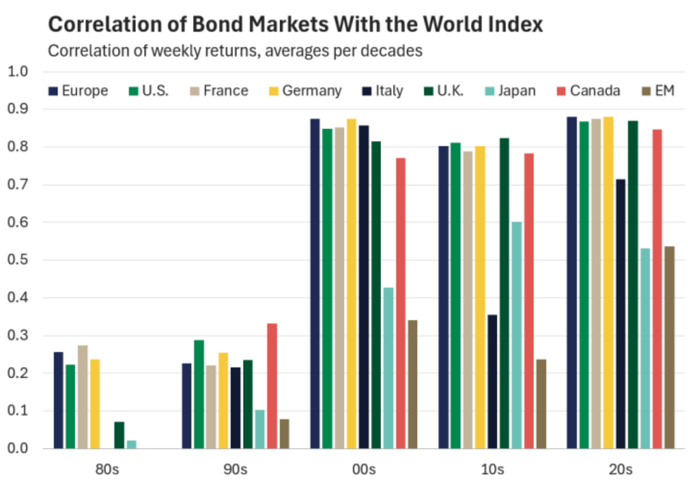
Market Review

JUNE 2025

Economic Review

When isolationism and unpredictability upset the balance

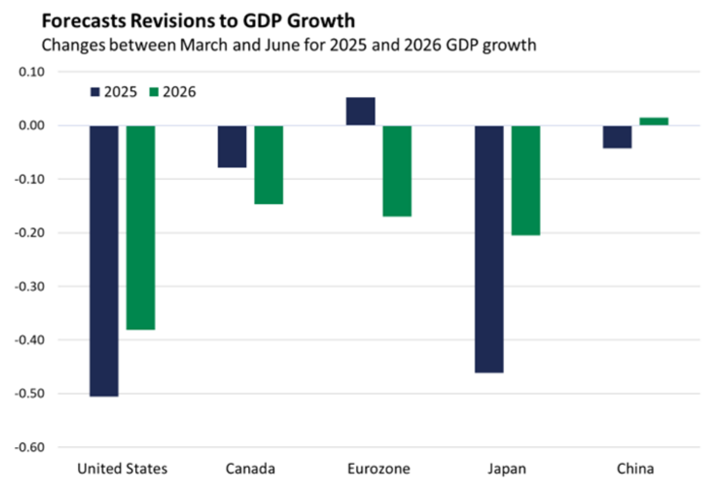
Since the end of the Cold War, the world has largely developed under a unipolar system, dominated politically, militarily, economically and technologically by the United States. However, with the establishment of the European Union, the rise of China and the emergence of regional economic powers like India, Brazil and Saudi Arabia, the global power dynamic has been gradually redefined.



Sources: DGAM, LSEG, Bloomberg, May 2025

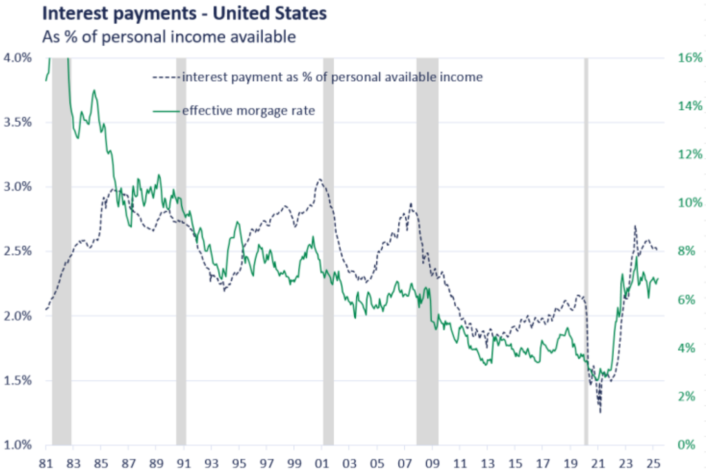
This shift to a multipolar order—long in the making—has accelerated under the Trump administration's isolationism and trade war. From an economic perspective, the transition is now unmistakable. This restructuring of the world order is not without consequences, as a multipolar world tends to be more fragmented and less predictable. New dynamics are taking hold, with some major powers competing to expand their influence, while others are drawing closer and strengthening their trade relationships.

In this more uncertain and fragmented context, economic forecasting has become particularly complex. The growth outlook has once again been revised downward, for both 2025 and 2026. Unsurprisingly, the US and Canada are seeing the strongest corrections, with growth rates now expected to fall below the 2% mark. Meanwhile, Europe and China are holding up relatively well, supported by more expansionary fiscal and monetary policies.



Sources: DGAM, Consensus Economics, June 2025

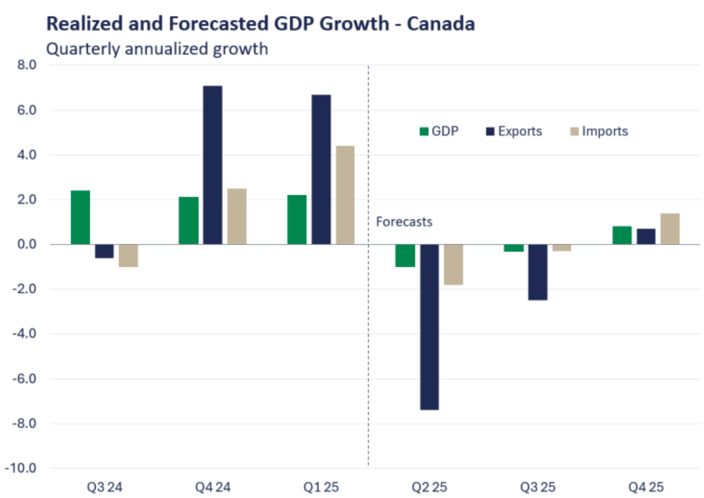
In the US, measures of economic activity, including employment, sales and output, point to a 3.5% rebound in GDP in the second quarter, after a 0.5% drop in the first. However, a closer look shows that nearly half of this rebound is the result of a sharp drop in imports, which had surged earlier in the year as US importers anticipated the implementation of new tariffs. This type of distortion clearly shows how difficult it can be to read the current economic environment, especially since the impacts of trade policies can take up to a year to fully materialize. At the same time, consumers are seeing their financial situation weaken under the combined pressures of growing debt and persistent job insecurity.



Sources: DGAM, LSEG, June 2025

The implementation of the One Big Beautiful Bill is unlikely to improve matters, as beyond adding to the budget deficit, its impact may well be detrimental for more vulnerable households. Inflation remains above the 2% target, giving the US Federal Reserve limited leeway. Excessive monetary easing in such a context would risk undermining the Reserve's credibility and renew concerns about its independence.

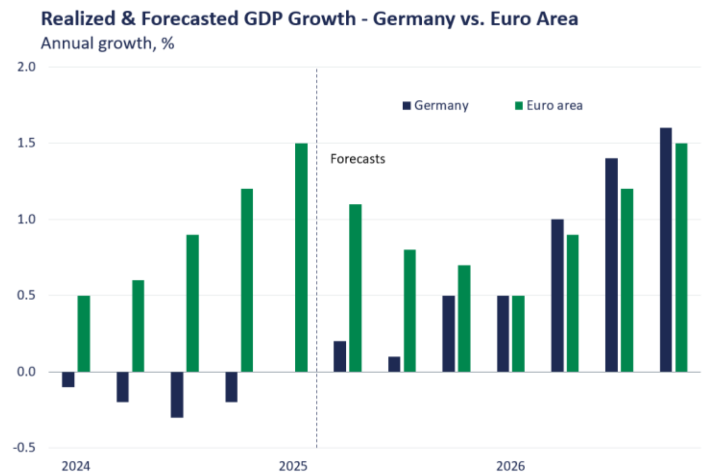
In Canada, inflation is now close to the 2% target, but the recent tariff increases continue to risk pushing prices back up. In the current context, the Bank of Canada may favour a gradual and cautious approach rather than significant monetary easing. Due to the persistent uncertainty, economic growth will likely remain volatile and fall short of its potential in the coming quarters.



Sources: DGAM, Bloomberg, June 2025

Many businesses are now putting their investment or expansion plans on hold. Exporters, meanwhile, must contend with increased costs and more complicated administrative requirements under CUSMA. These constraints are forcing them to rethink their supply chains, which is weighing on export volumes. Among households, consumer confidence is at historically low levels, holding back the recovery of the housing market despite declining mortgage rates. On top of that, tighter immigration thresholds are a further short-term drag on economic activity. Nevertheless, the country's fiscal capacity remains strong. The federal government recently announced stimulus measures focused on infrastructure and defence as well as tax relief aimed at spurring demand. While these measures should help ease the economic slowdown, their short-term impact will remain limited.

In Europe, Germany is getting ready to hit the gas with an ambitious stimulus plan and a significant increase in military spending. Few countries have the spending room needed to follow suit, however. Germany's debt ratio is slightly above 60%, while in Italy, France, Belgium and Spain it exceeds 100%. For now, a sense of urgency and public acceptance are supporting increases in military budgets, but this support could be challenged if such increases are made at the expense of social programs.



Sources: DGAM, Consensus Economics, June 2025

In the short term, the European Union must also respond to the impact of US tariffs and the uncertainty caused by trade tensions. On the monetary front, the European Central Bank (ECB) has already eased its policy considerably: With a key rate at 2%, conditions remain strongly expansionary. Europe has nevertheless repeatedly shown that it can present a united front in times of crisis. In 2022, at the height of the energy crisis, governments stepped up to soften the impact of price increases on households and businesses, reduce gas consumption and diversify supply sources. Our current analysis suggests that the key European players once again share a common sense of urgency and are serious about taking action.

In Asia, we're seeing a strengthening of trade ties between its 3 manufacturing giants—China, Japan and South Korea—which together account for nearly 30% of global GDP. These traditionally rival economies have drawn closer since the start of the Trump administration's trade war, aiming to create a more predictable business environment, consolidate their supply chains and eventually reach a free trade agreement. This rapid and strategic change sheds some light on China's more independent attitude toward US trade policies and confirms the shift to a multipolar world order. The US remains a key market for all 3 countries, however, with 15% of Chinese exports bound for the US, and 20% in the case of Japan and South Korea. So, while the trade war will have its consequences, it doesn't signal a major disruption for the region either. On the one hand, the US isn't in a position to replace these imports with local production in the short or medium term. On the other, countries are diversifying their export markets at an increased pace to reduce their reliance on the US market. The belligerent and unpredictable attitude of the US is undermining the growth prospects of US multinationals in Asia. Asian and European companies, which are perceived as more stable, are better positioned to take advantage of a rapidly growing regional market. It’s becoming harder for US firms to build the trust relationships they need to integrate into Asian supply chains. What's more, the brand image of US products has noticeably deteriorated, particularly in China, a key US export market.

Ultimately, with the global environment shifting toward a multipolar model, investors would benefit from rethinking entrenched ideas about the traditional sources of diversification. Investment policies based on major benchmark indexes must be rethought in light of new geographic and geopolitical dynamics. Making the most of this shift will require a capacity for strategic adaptation; we will have to look boldly beyond the structures imposed by such benchmarks.

Canadian Fixed Income

In the second quarter, the 10-year yield on Canadian bonds went from 2.97% to 3.25%. Over the same period, the FTSE Canada Universe Bond Index returned 0.57%. Corporate bonds in this index declined overall by 0.6%. This result is due to a general increase in interest rates that could not be offset by current returns and tighter credit spreads.

Provincial Credit

Throughout the quarter, provincial bond spreads tightened steadily, with only minor disruptions along the way. As expected, supply was plentiful, but the ability of provinces to issue on international markets helped stabilize spreads at the national level. The 5-year benchmark spreads for Ontario bonds thus tightened from 27 to 20 basis points (bps), while 10- and 30-year spreads tightened by about 10 bps, to 55 and 85 bps, respectively.

Not surprisingly, rating agencies reacted to the deterioration of provincial finances. Quebec and British Columbia saw their ratings drop one notch. For 5 other provinces, including Ontario and Alberta, the credit outlook has been revised downwards. However, there was little reaction on the markets to these announcements. Quebec and British Columbia, which are more active on international markets, saw their spreads tighten more than those of other provinces, by 2 to 3 bps. Towards the end of the quarter, Alberta, Quebec and New Brunswick reported that they would close the 2024–2025 budget year in better shape than expected. Encouraging news: This could result in several billion dollars less in financing needs for the current year.

For the next quarter, we still believe that long-term provincial bonds offer better value than similar-maturing corporate bonds, given the lack of issuance in the latter security category. We’re reluctant to increase our exposure after spreads have decreased by 10 bps, but we’re aware that low summer liquidity can lead to sudden changes. In addition, trade tensions appear to have eased and the provinces are ahead of their financing schedule, making it unlikely that spreads will significantly increase in the coming months. A wave of long-term corporate stock issues could slightly shock the provincial market, but there is no indication that this is imminent. Given these circumstances, we will continue to make prudent adjustments. If necessary, we’ll be ready to reduce our position if the spreads get too large.

Corporate Credit

Corporate credit spreads tightened by about 16 bps during the quarter. At the end of the period, all sectors benefited from an environment marked by a positive sentiment toward credit risk. Issuers continue to have strong economic fundamentals and demand for their bonds remains very strong in North America. These 2 factors contributed to a 10-point tightening of the US CDX index.

Long-term bonds performed better, supported by the debt buybacks announced by Bell and Telus. Since March, these two issuers have withdrawn $3.2 billion in long-term debt from the market and refinanced it through the issue of shorter-term hybrid securities. These instruments are considered as equal shares of debt and equity financing, which helps improve the financial leverage profile. Since the beginning of the year, long-term stock issues have totalled nearly $4.5 billion, for a net volume of only $1.3 billion once the Bell and Telus buybacks are taken into account.

While the North American economy remains resilient for the time being, current data does not yet fully reflect the potential effects of the Trump administration’s tariff policy. We believe that the risk-return profile of current credit spreads does not take future economic issues or rising geopolitical tensions into account. That being said, we recognize the technical support the market enjoys, particularly given the strong demand for corporate credit and the attractiveness of current returns for some investors. We recommend maintaining an underweight position in corporate credit while prioritizing the short part of the curve.

Fixed Income Strategy

The quarter was marked by high volatility, with a high level of uncertainty at the end of the period, particularly with regard to the potential budgetary impact of a more expansionary approach to government financing programs, including an increase in military spending. Discussions around a stagflation scenario in the United States are also resurfacing in light of the policies adopted there. If these fears materialize, risky assets and long-term fixed-income securities could underperform.

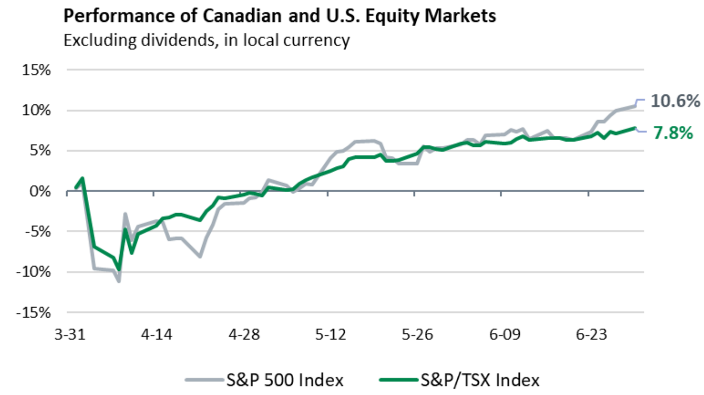
Despite a large volume of corporate securities issues in June and significant provincial funding, these instruments outperformed federal bonds during the quarter. We took advantage of these conditions to reduce our overweighting in provincial securities over the long term while maintaining an underweight position in securities of the same maturity. In addition, a rebound in market rates made it possible to extend the duration of portfolios in relation to their benchmarks by focusing our purchases in the 5-year segment of the curve, which we still consider attractive. We continue to see this as a source of value if the Bank of Canada's key rate reaches the bottom of its neutral range, in a context of gradual slowdown of inflation towards the 2% target.

Stock Markets

Canadian and US Equities

During the second quarter, uncertainty around the Trump administration's trade policy—with the April 2nd announcement of a 10% tariff on all products from countries with which the US is in a trade deficit—caused North American markets to react strongly. This announcement triggered a strong correction, ushering in a highly volatile quarter. However, the situation subsequently stabilized through the suspension or deferral of certain tariff measures, which allowed market indexes to rebound.

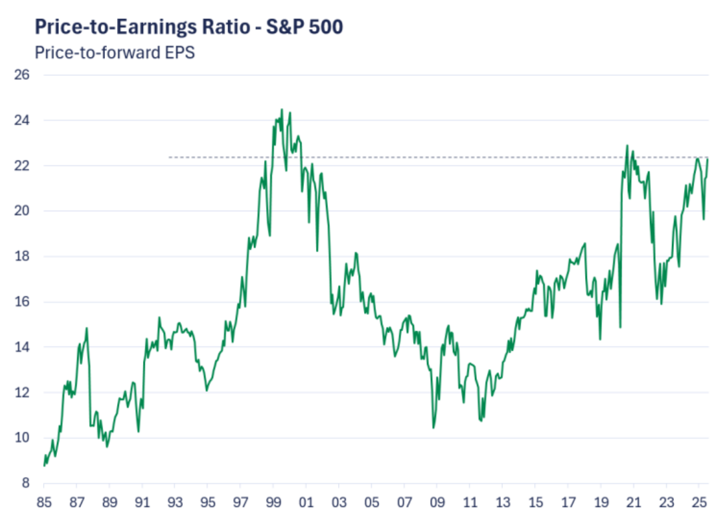
The S&P/TSX Index, which was down about 10% at the beginning of the quarter, ended the period up 8.5% (including dividends in CAD) higher compared to March 31, 2025. US indices, for their part, also finished in positive territory after recording the worst quarterly results at the beginning of the year. The S&P 500 Index gained 10.9% during the quarter, while the NASDAQ rose by 18.0% (including dividends in USD) supported by a marked rebound in interest in tech stocks, which recovered significantly after their first quarter drop.



Sources: DGAM, Bloomberg, June 30, 2025

Despite the current context of uncertainty, investor risk appetite has intensified, with a marked return to high-beta stocks, particularly those related to the dominant theme of artificial intelligence. Recent data from the Bank of America's Fund Manager Survey shows some renewed macroeconomic optimism. Less than half (46%) of survey participants expected the global economy to weaken in the coming months, compared to 82% in April.

As for company valuations, data have improved in recent months, particularly for the information technology and consumer discretionary sectors. At the end of the quarter, the S&P/TSX Index was trading at around 16.1x projected corporate earnings, a marked improvement over 13.5x in early April. In the US, the S&P 500 Index was trading at 21.1x corporate earnings, compared to 21.3x, three months earlier.



Sources: DGAM, LSEG, June 2025

As for earnings per share, analysts agree that we'll see sustained growth in 2025, in the order of 7.2% over the next 12 months for Canadian companies and 10.3% for their US counterparts.

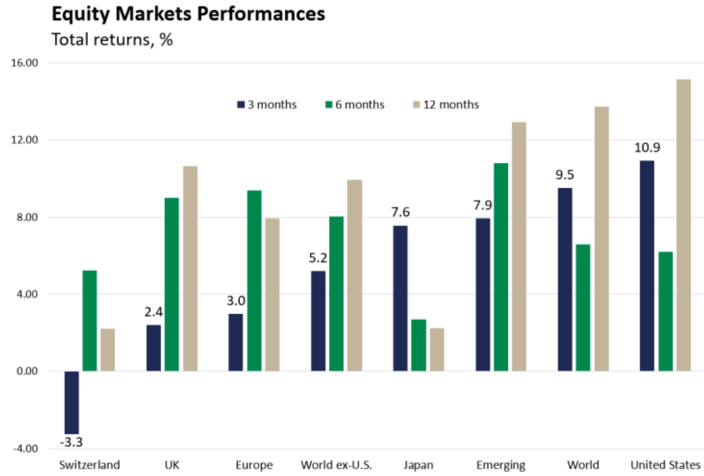
In Canada, all industry sectors posted positive results in the second quarter. Information technology and consumer discretionary sectors led the way with returns above 14%; such results constitute a significant turnaround for these two sectors, whereas in the previous quarter they had a decline of more than 7.0% and a zero return, respectively. Celestica had the best returns at 87.4%, which showed a renewed interest in tech stocks.

Consumer discretionary sector companies that had been impacted by trade tensions at the start of the year rebounded following the suspension and deferral of tariff measures. This was the case for Aritzia and BRP, with returns of 39.5% and 37.1%, respectively. Moreover, sentiment remained favourable for gold stocks, due to ongoing uncertainty as well as sustained purchases from central banks, which led to increased flows to smaller-cap companies, including Lundin Gold, which posted a 64.3% gain. The energy, communication services and consumer staples sectors had more of a limited contribution to performance in this quarter.

More than ever, current economic conditions call for caution. We are maintaining a disciplined strategy while remaining sufficiently agile to progressively initiate positions. We are keeping a core of high-quality securities while taking advantage of opportunities in securities that have undergone sharp corrections, provided the economic fundamentals of their industry point to a recovery. This is particularly true for companies in the industry and finance sectors. This balanced approach allows us to remain exposed to opportunities while actively managing the risks inherent in the current environment.

International Equity

Despite ongoing economic and geopolitical uncertainty, global equity markets reached a new high in the last quarter, with a 9.5% gain in the MSCI World Index (net dividends reinvested, in local currency). The US market rebounded significantly after a downturn in early April. The MSCI USA Index saw its value increase by 11.2% (S&P 500: 10.9%). However, with a cumulative return of 6.1% since the start of the year (S&P 500: 6.2%), it lags behind other developed markets (net dividends reinvested, in local currency).



Sources: DGAM, MSCI, LSEG, June 2025

European equities overall posted the weakest return at 3.0% due to seesaw trading sessions. However, for the first half of the year, they posted the strongest return with 9.5% (net dividends reinvested, in local currency). Japanese equities also rebounded, with the MSCI Japan index posting a 7.6% gain after a disappointing first quarter (net dividends reinvested, in local currency).

In terms of sector, stocks in the cyclical and growth sectors came out at the top. Technology, communication services and industry indexes increased by 21.5%, 16.8% and 12.2%, respectively. However, defensive sectors underperformed. The health sector fell 5.7% due to public policy concerns, making it the most underperforming sector since the start of the year, with a 2% drop. The utilities sector grew by 5.5%, benefiting from the business growth profile. Overall, the 24% performance gap between the defensive and cyclical sectors was the largest seen since 2010.

Sources: DGAM, IBES, MSCI, June 2025

The market rebound was supported by reduced fears of a recession and easing trade tensions. The outlook remains uncertain, particularly in the United States, where average tariffs are expected to remain high despite the easing of tensions. Earnings forecasts for 2025 have been revised downward, but solid growth is still expected for 2026 and 2027. That being said, if the increased operating costs related to the tariffs are taken into account, returns could be lower than historical averages.

Valuations have become tighter, with the MSCI World Index now falling to the 93rd percentile of its historical distribution. US equities remain the most expensive, at the 99th percentile, while European and Asian markets have more moderate valuations, at the 83rd and 79th percentiles, respectively. Despite macroeconomic headwinds, global equity valuation multiples remain slightly lower than those observed at the beginning of the year, as analysts continue to expect strong earnings growth.

Investor sentiment has improved, as evidenced by our internal confidence index, which is now back in positive territory. Markets seem to be unaware of the concerns related to valuations and the macroeconomic context.

Emerging Markets Equity

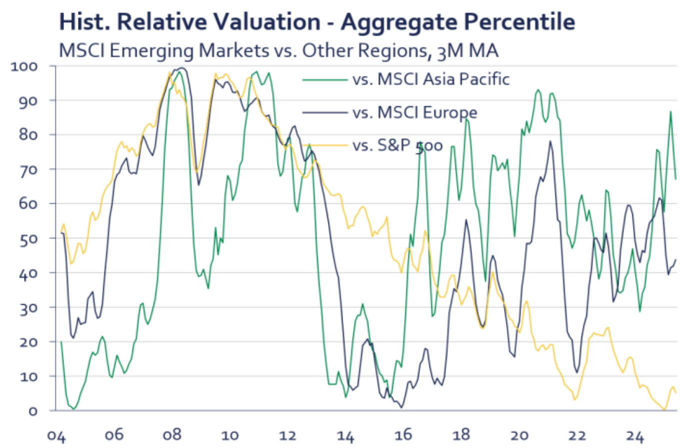
Growth in emerging countries came as a positive surprise in the first half of 2025. Anticipation of further tariff increases in the US led to orders being placed earlier, while the temporary truce announced shortly thereafter helped support world trade. In India and China, the 2 largest emerging economies, government spending has been accelerating, boosting domestic activity.

However, support for international trade related to earlier exports is expected to wane, possibly leading to a slowdown in commercial activity. It's important to remember that even if some countries succeed in reaching an agreement with the United States, US tariffs are likely to remain higher than before President Trump took office.

Conversely, the fiscal policy of major emerging markets should remain expansionary. The continued disinflation process, combined with the depreciation of the US dollar, is creating the right conditions for further rate reductions in several emerging economies. The actual high rates provide significant leeway to central banks.

Since the beginning of the year, emerging market equities have posted a significant gain of 10.8%, outperforming developed markets by 4.2% (net dividends reinvested, in local currency). Equity flows to these markets continue, while investor positioning remains reasonable, leaving room for additional support potential.

In terms of valuations, our standardized model indicates a slight deterioration in equities during the second quarter, moving from the 77th to the 83rd percentile of their historical distribution. Emerging markets are still very attractive compared to developed markets, particularly compared to US equities.



Sources: DGAM, LSEG, Bloomberg, June 2025

In the context of persistent economic and geopolitical uncertainty, we continue to focus on regions and sectors with more local demand exposure. We strengthened our positions in the Indian and Brazilian markets, to the detriment of Southeast Asian securities. We are also favouring Chinese equities and the communication services sector over Taiwanese equities and commodities sectors.

Asset Allocation

Convictions and vigilance: A balance to be maintained

Despite the uncertainty generated by the Trump administration's unpredictable decisions, we have been seeing an ongoing gap between the developments of certain overheated markets and their underlying economic data. This is particularly the case for US large-cap equity indexes and high-yield corporate bonds, two segments that seem to incorporate flawless scenarios.

Such episodes were observed in 2000, 2012 as well as during the pandemic. Every time, prices ended up readjusting, either upwards or downwards, according to the companies' economic realities. These atypical periods make the portfolio managers' work more difficult, as they estimate the value of assets based on the analysis of real economic data. Tactical asset allocation management is no exception.

This unusual context tests the convictions arising from the fundamental analysis and requires stringent risk management. The team still refers to these convictions, but takes into account the market environment by adopting more modest weightings and strategies based on price momentum.

The table besides presents our positioning recommendations as at June 30, 2025. We are lowering our recommendation on Canadian and US bonds while placing greater emphasis on cash. Our recommendation on emerging market equities is now neutral.

POSITIONING	- -	-	0	+	++
CANADIAN EQUITY	☐	☑	☐	☐	☐
US EQUITY	☐	☑	☐	☐	☐
EMERGING MARKET EQUITY	☐	☐	☑	☐	☐
EAFE EQUITY	☐	☐	☑	☐	☐
WORLD EQUITY	☐	☑	☐	☐	☐
US 10Y BONDS	☐	☑	☐	☐	☐
CANADIAN 10Y BONDS	☐	☐	☑	☐	☐
CAN. CORPORATE BONDS	☐	☑	☐	☐	☐
PREFERRED SHARES	☐	☐	☑	☐	☐
CASH	☐	☐	☐	☑	☐

■ Fixed Income					
Yields to maturity - Canada	**Current level**	**1 month**	**3 months**	**6 months**	**1 year**
Bank of Canada overnight rate	2.75%	2.75%	2.75%	3.25%	4.75%
2 years	2.59%	2.59%	2.46%	2.93%	4.00%
10 years	3.27%	3.20%	2.97%	3.23%	3.50%
30 years	3.56%	3.48%	3.23%	3.33%	3.39%
Credit market	**Current level**	**1 month**	**3 months**	**6 months**	**1 year**
Mortgage rate (prime rate)	5.0%	5.0%	5.0%	5.5%	7.0%
5-yr credit spreads (CDX.IG)	51	56	61	50	53
5-yr High yield credit spreads (CDX.HY)	318	351	376	311	344
5-yr Emerging debt credit spreads	295	306	318	297	344

■ Fixed Income					
Yields to maturity - United States	**Current level**	**1 month**	**3 months**	**6 months**	**1 year**
Fed rate	4.50%	4.50%	4.50%	4.50%	5.50%
2 years	3.72%	3.90%	3.88%	4.24%	4.75%
10 years	4.23%	4.40%	4.21%	4.57%	4.40%
30 years	4.77%	4.93%	4.57%	4.78%	4.56%
Credit Market	**Current spread**	**1 month**	**3 months**	**6 months**	**1 year**
Spreads Ontario - 10 years	57	61	65	57	64
Spreads utilities - 10 years	92	95	105	95	116
Spreads communications - 10 years (BBB)	125	130	143	132	156
Spreads banks - 10 years	32	33	38	30	50

■ Fixed Income indices					Total return
	Current level	**1 month**	**3 months**	**6 months**	**5 years (ann.)**
FTSE Provinces index	1355	0.0%	-1.0%	5.6%	-1.6%
FTSE Municipal index	1479	0.1%	-0.7%	6.4%	-0.6%
FTSE Corporate index	1472	0.3%	0.5%	8.2%	1.7%
FTSE Overall	1186	0.1%	-0.6%	6.1%	-0.4%

■ Equities					Total return C$
	Current level	**1 month**	**3 months**	**6 months**	**5 years (ann.)**
S&P/TSX Composite	26857	2.9%	8.5%	26.4%	15.1%
S&P 500	6205	4.1%	5.2%	14.7%	16.6%
MSCI World	4026	3.4%	5.8%	16.4%	15.1%
MSCI Emerging Markets	1223	5.1%	6.3%	15.5%	7.2%
MSCI Global Small Cap.	599	3.8%	5.9%	14.6%	11.5%

■ Currencies					Variation
	Current level	**1 month**	**3 months**	**6 months**	**5 years (ann.)**
CAD/USD	0.73	1.0%	5.7%	0.5%	-0.2%
CAD/EUR	0.62	-2.8%	-3.0%	-8.6%	-4.9%
CAD/GBP	0.54	-1.1%	-0.5%	-7.5%	-9.9%

■ Misc.					Yield / return
	Current level	**1 month**	**3 months**	**6 months**	**5 years (ann.)**
VIX *(level)*	17%	19.0%	22.0%	12.0%	30.0%
Bloomberg Commodity Index	102	1.1%	-9.1%	0.7%	9.5%
Gold	3303	0.4%	5.7%	42.0%	13.1%
WTI crude oil	65	8.9%	-6.5%	-12.5%	7.7%

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