July 11, 2025

The first half of 2025 is done, and here is a review.

The second quarter of 2025 began with equity indexes plunging on the heels of the April 2 US announcement of sweeping tariffs on almost every trading partner worldwide. Volatility, as measured by the Vix index, soared and bond yields jumped as fixed income markets also tumbled. The quarter also delivered an array of geopolitical jolts, including a short but potentially devastating conflict between Israel and Iran. In this often-turbulent environment gold rose sharply in early April and hit a record high in mid-June before closing Q2 slightly off its peak. The sudden onset of a major Middle East confrontation caused a sharp, but brief, spike in the price of oil and by quarter end it was below where it began the three-month period.

Stock markets staged a remarkably rapid and strong recovery from the early April sell off as the quarter unfolded, with major indexes surging to record highs by the end of the period. Resilient corporate earnings supported the optimistic outlook and US investors also noted a calmer tone regarding the crucial US/China trade negotiations. Despite tariff turbulence, US inflation remained steady near the Federal Reserve's 2% target.

US Treasury markets ended Q2 with expectations that the Federal Reserve will begin trimming interest rates in Q3, with the two-year yield falling slightly to 3.72% by the end of the period. In the longer-run, however, analysts expect investors to demand higher returns to finance the growing US budget gap, and the yield on the benchmark US 10-year note declined less, closing Q2 at 4.23% after hitting 4.6% in late May. Yields rise as bond prices fall.

Strong gains in Q2 put all North American equity indexes into positive territory on both a year to date and rolling 12-month basis to June 30. For the one-year period, Canada continued to lead, with gains for the S&P/TSX Composite Index remaining well ahead of those for the S&P 500, but trailing in the month of June.

For the quarter, the S&P/TSX Composite Index ended up 8.53%, the S&P 500 Index rose 10.83%, the Nasdaq Index soared 17.96%, the MSCI World Index was up 9.51%, and the MSCI EAFE Index rose 4.80%. In the U.K., the FTSE 100 Index rose 3.17% and Germany's DAX Index climbed 7.88%. In Asia, Japan's Nikkei 225 jumped 13.83%. The FTSE Canada Universe Bond Index ended the quarter down 0.57%.

Early in June, the Bank of Canada (BoC) maintained its policy rate at 2.75% for a second consecutive meeting, citing potential inflationary pressures as a key reason for caution. BoC Governor Macklem stressed that May and June inflation data will influence future rate decisions as the BoC waits for more details on the extent of tariff impacts. Several weeks later, Statistics Canada reported that inflation rose 1.7% in May (YoY), the same as April, and in line with expectations. Housing costs rose 3%, less than the 3.4% increase in April. StatsCan noted that Ontario was the leading source of rent relief nationally. Mortgage interest costs slowed for the 21st consecutive month.

The end of the consumer carbon price helped trim gas prices, but the cost of groceries rose 3.3% in May, annualized, half a percentage point less than the increase in April. Lower travel costs also dampened inflation in May. Inflation, excluding the impact of the carbon price removal, was steady at 2.3% in May. Growth stalled however as GDP slipped by 0.1% in April according to Statistics Canada, and its preliminary reading for May indicated a further 0.1 % contraction. The manufacturing sector fell 1.9% in April, the most since April 2021. Durable goods manufacturing sagged 2.2% %, while non-durable goods fell 1.6%.

The unemployment rate rose to 7.0% in May, up from 6.9% in April, and its highest level since September 2021. Manufacturing was hit hardest, with a net decline of 12,200 jobs as high tariffs on the aluminum, steel, and auto industries began to bite. Retail sales rose 0.3% (MoM) in April, but Statistics Canada's preliminary estimate for May foresees a sharp 1.1% decline.

In the US, a third and final Q1 2025 GDP estimate from the Commerce Department released at the end of June said the US economy contracted at an annual rate of 0.5% in the first quarter. In Q4, 2024 GDP expanded 2.4%. The Q1 contraction primarily reflected an increase in imports (seeking to front-run tariffs), which are a subtraction in the calculation of GDP and a decrease in government spending, according to the US Bureau of Economic Analysis.

US labour data was somewhat better than expected, with no signs of a sharp slowdown, and the unemployment rate held at 4.2% in May. However, downward revisions to the total number of new jobs added in March and April and sector-specific weakness – particularly in manufacturing – flagged underlying softness and employer caution. The US Core PCE price index ticked up in May to 2.7% (YoY) after hitting a four-year low in April, suggesting that the expected impact of President Trump's tariffs has not yet fed through to prices in a significant way.

US personal spending softened in May, falling by 0.3% MoM, led by a pullback in goods, particularly autos, following an earlier rush in the year to get ahead of any tariff-related car price increases. Personal income slipped by 0.4% MoM. Retail sales fell 0.9% MoM in May, the largest drop in over two years. The decline, however, was significantly influenced by the pullback in auto sales, but underlying data suggested relatively stable demand.

The US Federal Reserve held the federal funds rate steady at 4.25% to 4.50%, citing ongoing uncertainty about the economic outlook. Fed Chair Jerome Powell expressed caution and noted the Fed's careful scrutiny of "the likely course of the economy before considering any adjustments to our policy stance." The June reading for the University of Michigan consumer sentiment survey came in at 60.7, up from 52.2 in May. US consumer expectations for inflation in the next 12 months fell to 5% from 6.6% a month ago. However, sentiment levels remain well below immediate post-election levels and suggest consumer expectations remain tilted towards an economic slowdown and rising inflation.

In Europe, the European Central Bank (ECB) lowered its policy interest rate a quarter point to 2%, as expected. The ECB trimmed its growth forecasts due to US trade uncertainty but signalled that it is nearing the end of its easing cycle. Eurozone inflation fell to 1.9%, annualized, in May, below the ECB's target of 2% for the first time in seven months and down from 2.2% in April.

In the UK, economic data suggested further softening as GDP fell 0.3% (MoM) in April, but quarterly growth remained positive because of earlier strength. The employment picture continued to deteriorate, with payrolls dropping by 109,000 in May and the unemployment rate climbing to 4.6%, the highest since May-July 2021. Inflation data for May was 3.4%, annualized, above the Bank of England's (BoE) target, and the BoE kept rates at 4.25% in June.

In Japan, wages rose 2.2% in April, YoY, but fell 1.8% when factoring in inflation. The Bank of Japan (BoJ) held its policy rate steady at 0.5%, citing a cautious outlook for economic growth. Governor Ueda emphasized continued economic uncertainty and concerns over wage dynamics, reinforcing a patient approach to policy tightening.

Australia's employment fell slightly in May, below expectations, though this followed strong growth in April. While employment growth has slowed from late 2024 levels, other labour market indicators suggest that labour market conditions remain relatively tight. Expectations that The Reserve Bank of Australia will trim its key policy rate by a quarter point at either its July or August meeting were reinforced by a drop in inflation in May to 2.1%, annualized, from 2.4% in April.

Chinese economic data indicated a mixed outlook. Consumption outperformed due to one-off subsidies, while industrial production and investment trailed expectations. Real estate continues to be a significant drag on the economy as home prices and sales continue to fall. Deflationary pressures persisted in May, with China's broad inflation reading falling 0.1%, YoY, for the fourth consecutive month. Core CPI inched up but lower prices for consumer goods and food pulled down overall inflation.

**What can we expect now?**

The second quarter got off to a rocky start but ended with solid gains for investors who stayed the course despite often daunting headlines. During the quarter, a growing sense that "cooler heads" could perhaps temper some of the more unexpected policy twists and turns emanating from the White House helped markets look past immediate volatility. Yet a great deal of consequential trade and tariff questions remain unresolved, for Canada and the world. In Canada, tariffs have started to hit home, particularly in autos, steel, and aluminum. Growth has flatlined and the unemployment rate inched up again. Uncertainty about our trading relationship with the US continues as the two sides engage in intense negotiations with a self-imposed deadline of July 21. In the face of these challenges Canadian equities have posted solid gains year to date. The second half of 2025 may produce further surprises but, possibly, better visibility for the future direction and sources of growth in 2025 and beyond. As always, maintaining a balanced portfolio reflecting your short- and long-term goals and requirements is prudent.

We are here to assist you in achieving those goals and look forward to discussing any questions you may have about how best to do that.

Sincerely,

John

**Note:**

All index performance is in Canadian dollars.

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