

2025 MIDYEAR INVESTMENT OUTLOOK



# The global reset

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**We view this as an opportunity for investors to diversify their portfolios across regions and asset classes, as well as to reduce concentrations. This may help in weathering volatility while also allowing investors to benefit from potential upside surprises.**

# Executive summary

The global economic and political landscape is shifting rapidly, marked by a broad reordering of trade relations and political alliances around the globe. In response, uncertainty measures across global markets soared in the first half of 2025. We make no apologies for acknowledging that there are plenty of things we do not know today. We remain wary about precise estimates of where tariff rates will settle, the exact timing of interest rate changes and detailed inflation and growth forecasts. These estimates, among others, are heavily dependent on a more consistent sense of US policy direction. That said, we have greater confidence in the direction of travel for some key trends, macro factors, and, ultimately, markets. We expect tariffs to be higher than in previous decades and US immigration to be lower. The result is likely to be slower growth and higher inflation in the US in 2025 than was expected at the start of the year, although better-than-expected resolution of tariff disputes and the positive impact of anticipated deregulation may continue to allow US markets to rally.

While US politics dominated the news flow in the first half of 2025, it is important to note that there have been developments elsewhere in the world that would have been the “story of the year” in more normal times.

In March, German Chancellor Friedrich Merz pledged to do “whatever it takes” to ensure the defense of Europe, releasing Germany’s debt brake and freeing the country to engage in greater infrastructure and defense spending. This bold move should provide a positive tailwind for European growth over the next decade.

China, too, is engaging in greater fiscal spending, and there are signs of improvement in the property and consumer sectors.

These green shoots are a further sign that while US tariffs will remain a drag on global growth, other factors are becoming more supportive of better growth outside of the US.

The US Federal Reserve (Fed) is in a tough bind. While most of the usual hard data point to keeping rates on hold, soft data point to an impending slowdown that could justify rate cuts. It is likely that US rates will stay on hold for a while longer but then be cut aggressively in the event of a significant slowdown in activity.

Other central banks have an easier task since US tariffs and a weaker dollar will likely add to disinflationary pressure in regions outside of the US and spur quicker and more cuts than were priced at the start of the year. Cuts from the European Central Bank are already helping European consumers who now have greater confidence to save less and spend more.

Of course, the Bank of Japan is the one major central bank that appears to be still on a tightening path. Further interest rate hikes may be delayed until the end of 2025 or early 2026. But we think more will come, just as other central banks ease. We suspect this will continue to support the Japanese yen.

So, while policy and economic uncertainty are high and there is much we cannot say for certain, we are confident in our base case that non-US assets are increasingly attractive and poised for continued outperformance. We view this as an opportunity for investors to diversify their portfolios across regions and asset classes, as well as to reduce concentrations. This may help in weathering volatility while also allowing investors to benefit from potential upside surprises.

There is much that our investment teams and other colleagues are debating today, given the magnitude and number of changes underway in the macro landscape, and we outline the key elements of some of those debates and questions in this outlook.

The start of 2025 has been a roller coaster for markets as investors reassess and reset expectations and beliefs about the global order. We expect more twists and turns to come. Hold on tight, the ride is far from over.

# Our outlook

## Macro views

(page 4)

### Uncertainty means businesses and households are less confident

Policy is changing rapidly and radically, which makes planning by businesses challenging.

### US economy slows but avoids recession

The tariff threat becomes more manageable, with the US economy facing a slowdown rather than recession. Policy may remain volatile, but the US focus may now turn to deregulation.

### China and Europe provide domestic support

The trade conflict creates serious challenges for surplus nations, but fiscal stimulus and easier monetary policy should counteract the worst effects.

## The path ahead

(page 5)

### Where does the trade war settle?

No one can provide a definitive answer to where tariff rates will land, but there can be little doubt that they will be higher than in previous decades. We offer three scenarios for the path ahead, predicated on how the trade war evolves.

## Investment themes

(pages 6-10)



### Positioning for uncertainty

We continue to favor a defensive positioning given current market and economic uncertainty and the potential for further volatility.



### The dollar continues to weaken

The outlook for US rates and growth suggests the dollar will continue to weaken.



### An exceptional run for US stocks may be coming to an end

US valuation premiums are being questioned, while earnings growth differentials are closing versus Europe and China.



### China joins the US in artificial intelligence dominance

The US is no longer the only game in town for exposure to cutting-edge technologies.



### Constructive on global bonds, neutral on US Treasuries

Yields may fall on slower global growth; US yields could push higher on fiscal concerns.

## What we're debating

(pages 11-16)

### Will the prolonged period of US outperformance continue?

Foreign investors are questioning whether to maintain large positions in US assets.

### What's the strike price of the "Trump put"?

What might cause the Trump administration to reconsider its major policy shifts?

### How will the US Treasury market respond to larger deficits?

The US economy has benefited from a fiscal boost since the pandemic, but adjustments may be needed.

### Can Europe escape a hit to growth from the trade war?

Expansionary fiscal policy and an improving consumer provide strong offsets.

### Is China's stimulus enough to counterbalance tariff headwinds?

Strong domestic policy support should help the economy attain target growth.

### Where are the attractive safe-haven assets\* today?

Gold remains a popular safe haven, along with CHF, JPY, and German, Japanese, and Swiss government bonds.

\* So-called safe-haven assets do not imply risk-free investments. Opinions expressed are those of the Global Market Strategy Office. This commentary does not constitute buy/sell recommendations.

# Macro views



## We don't yet know the full effects of the trade war

As policies continue to shift rapidly, businesses have been faced with difficult hiring and investment decisions while consumer sentiment has struggled. We anticipate that these policies and the related uncertainty will push growth lower and prices higher in the US, but by how much remains an open question. Moreover, even if the trade war is resolved relatively quickly, there likely will still be significant effects due to supply chain shocks and other disruptions.



## US businesses and consumers brace for slowdown

Policy uncertainty is weighing on consumer sentiment, indicating a challenged outlook for the US economy while the Fed continues to slow-walk its rate-cutting cycle. We expect a slowdown in US growth over the coming quarters. However, strong overall household balance sheets should help limit the impact.



## China and Europe turn to domestic policies

The US pullback on the global stage creates challenges for surplus nations, but an increase in stimulus should counteract the worst effects. Overall, we anticipate non-US economies to see less of a growth hit from the trade war than the US.

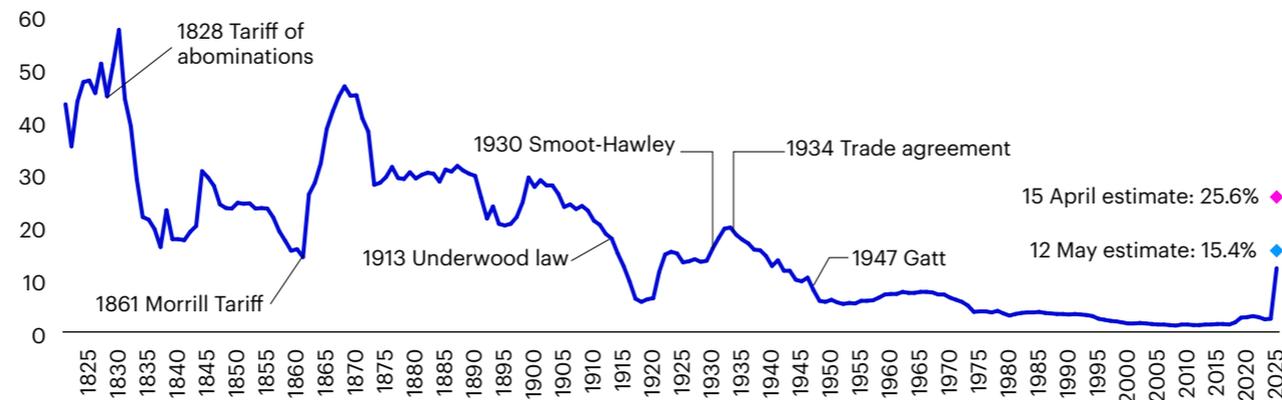
**Europe:** Rate cuts and a ramp-up in fiscal support, including Germany's infrastructure spending surge, should shield economic growth from the worst impacts of US tariffs and reordered trading relationships. Europe may see downward pressure on prices and output as a result of the trade war and a weaker dollar.

**Japan:** A return of real wage growth in Japan should help boost consumption, but its trade exposures pose a challenge for growth. We expect the Bank of Japan to hold off on further rate hikes through the remainder of the year.

**China:** A ramp-up of government support suggests Chinese growth will avoid a significant downturn despite the trade war.

## US tariffs are now at 90-year highs

Average US tariff rate on all imports, %



Sources: Invesco, Macrobond, Tax Foundation, and Yale Budget Lab as of 16 May 2025, <https://budgetlab.yale.edu/research/state-us-tariffs-may-12-2025>. The average US tariff rate is calculated by taking total collected tax duties as a proportion of imports. The 15 April and 12 May estimates are derived from Yale Budget Lab estimates that project customs duty revenues as a percent of goods imports, after modelled substitution effects.

# How does the trade war evolve from here?



## Downside scenario Geopolitical breakdown

US trade policy triggers reciprocal tariffs from other nations, and limited deals are negotiated. Geopolitical tensions escalate further with imports to the US falling significantly. This may entail a further breakdown of the international order and/or a significant rupture of relations between the US and China. The US enters a recession, and global growth experiences a significant slowdown, while tariffs elsewhere push up prices outside of the US.

### Favored assets

- Equities
  - Non-US low volatility and defensives, especially utilities and telecoms
- Fixed income
  - Sovereign debt, especially non-US
- Alternatives
  - Potentially attractive entry point for distressed debt and special situations
  - Hedged strategies
  - Gold and precious metals
- Currencies
  - JPY, CHF

## Base case Uncertainty continues

US domestic policy volatility and uncertainty are likely to persist for the remainder of 2025. US tariffs remain at multi-decade highs but well below levels initially announced on “Liberation Day,” and US-China trading relations gradually improve. These combined effects likely cause a mild slowdown in the US economy, although the extension of tax cuts and deregulation could provide a tailwind. Disinflationary pressures in Europe and China should allow governments and central banks to stimulate their domestic economies.

### Favored assets

- Equities
  - European equities
  - UK equities
  - Asian equities
- Fixed income
  - Global ex-US bonds (corporate and sovereign)
  - Local currency emerging market bonds
- Alternatives
  - Private credit (including real estate)
  - Hedged strategies
  - Industrial metals
- Currencies
  - EUR, GBP



## Upside scenario Policy and trade war reprieve

The US administration engages in a policy pivot, tempering tariff and immigration policy while focusing on more pro-growth policies. (potentially due to Congress reining in executive trade authority). A partial normalization of trade policy results in an incomplete return to the pre-2025 state. Growth outlook improves materially outside of the US and offsets a mild US slowdown. US-China relations improve.

### Favored assets

- Equities
  - Value, small and mid cap
- Fixed income
  - US investment grade
  - US high yield
- Alternatives
  - Private equity and real estate equity
  - CLO equity
  - Industrial commodities
- Currencies
  - USD
  - Commodity currencies (AUD, CAD)

# Positioning for uncertainty

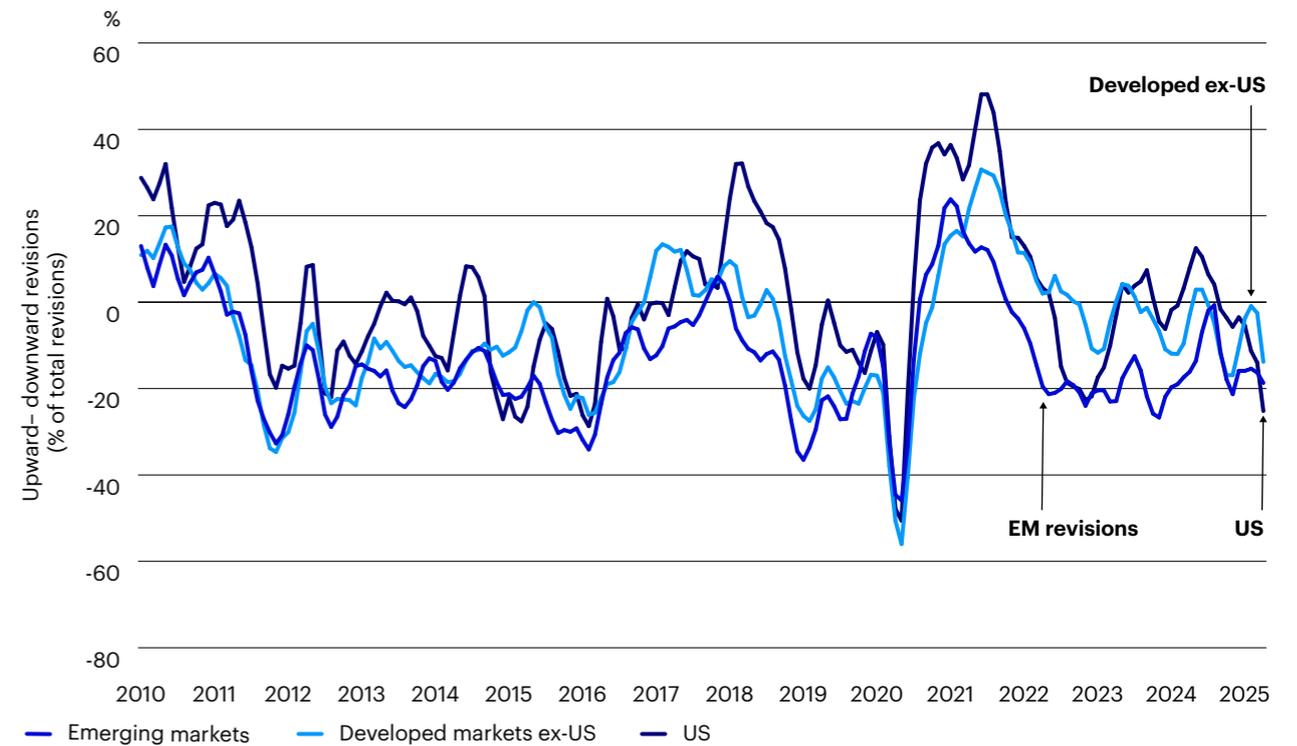
Markets appear to have recovered much of their poise after a period of extreme volatility following the “Liberation Day” announcement of reciprocal tariffs and subsequent pauses in their implementation. Nevertheless, we favor broad diversification across geographies and asset classes given continuing uncertainty and the potential for further surprises.

- Substantial policy volatility has sent business confidence and consumer sentiment lower, especially in the US. We see growth slowing globally, yet markets have already recovered their poise since the initial Liberation Day reaction. Given current pricing, contrasted with budding growth headwinds, we favor a move to higher quality parts of the market. Indeed, earnings forecasts are deteriorating across developed and emerging markets, led by downward revisions in the US. While ex-US developed markets are outperforming on a relative basis, the deterioration in earnings forecasts appears to be global and synchronized.
- After an impressive run, US equities look particularly exposed due to elevated valuations. We favor low volatility, quality, and high dividend factors within the US while limiting exposure to mega-cap names. We anticipate non-US equities to outperform through the remainder of the year, led by European and Asian equities.
- In fixed income, given the backdrop of uncertainty and tight valuations, we think caution around risk-taking is appropriate. Given the heightened policy volatility and uncertain fiscal outlook in the US, we prefer ex-US global bonds. We favor a slight underweight across most credit sectors and a generally cautious approach to portfolio risk-taking.
- We remain neutral on risk for alternative assets due to elevated downside growth risks, high equity valuations, and benign capital markets activity. In general, we remain more defensive in this area, favoring private debt and hedged strategies versus private equity.\*
- In commodities, we like industrial metals for their low correlations to other assets alongside their ability to participate in performance in the event of economic reacceleration. Similarly, in currencies we favor major developed currencies such as EUR and GBP.

\*Please see our quarterly Alternatives Opportunities publication for a more detailed discussion of our views on alternative assets.

## Global tariff policies causing a synchronized deterioration in earnings expectations, led by downward revisions in the US

Upward minus downward revisions, % of total revisions, 3-month moving average



Sources: Bloomberg L.P., JPMorgan, Invesco Solutions research and calculations, from January 2010 to April 2025. 12-month forward earnings revisions computed as the number of upward revisions minus the number of downward revisions divided by total number of revisions.

**Past performance does not guarantee future results.**

# The dollar continues to weaken

Foreign investors have been recycling surpluses into USD assets for well over a decade. That trend may be starting to reverse. 2025 growth forecasts are falling more quickly in the US than in the rest of the world, and we expect further USD weakness in H2.

- The US dollar has had a strong run over the last 15 years and appears rich on a real trade-weighted basis. Since the Global Financial Crisis, dollar assets have been in favor as the US delivered stronger growth than most other major economies.
- Foreign investors have allocated to US assets significantly (see page 11) and have largely benefitted by holding these assets unhedged. USD appreciation has compounded foreign investor returns and protected investors in times of stress. However, as uncertainty about the US mounts, greater hedging activity may put downward pressure on the USD.
- Both friend and foe of the US are now reconsidering their exposure to the USD. Since 2022, strong central bank buying of gold has been one sign that reserve managers are seeking to diversify away from the USD. If that trend continues, the USD could be on a longer-term weaker path—an outcome that the US administration is not fighting against.
- Nearer-term factors, such as the growth outlook, also point to a weaker USD. US growth is now anticipated to be softer compared to expectations at the start of the year. Growth forecasts for non-US economies have been trimmed, too, but to a far smaller degree. The narrowing of relative growth differentials with the US point to a weaker USD in the second half of 2025.
- The US Federal Reserve remains in “wait-and-see” mode, as labor market and inflation data suggest maintaining rates at current levels for a while longer. The Fed will likely cut rates quickly if the data start pointing to a recession. Other G10 central banks, excluding the Bank of Japan, are benefitting from disinflationary pressures that we expect to enable more rate cuts and sooner. Normally, that would mean yield differentials move in favor of the USD, but today, we think that relationship breaks because the proximate cause of weaker growth in the US is a perceived US policy error.

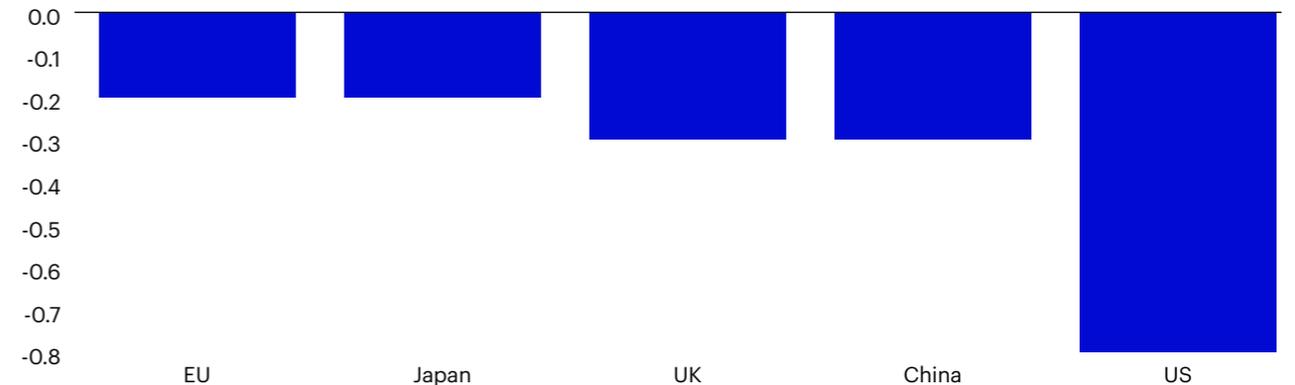
## USD has fallen this year but is still rich

Real USD trade-weighted index, (Monthly data, from January 1970 to April 2025)



## US growth forecasts have fallen more than other major economies

Change in consensus 2025 GDP forecasts since January



Sources: Invesco and Bloomberg L.P., as of 2 May 2025. Real USD trade-weighted index is based on the Goldman Sachs real trade-weighted dollar index. Change in Bloomberg consensus growth forecasts 31 January 2025 – 16 May 2025, in percentage points. Consensus 2025 GDP forecasts are derived from ongoing Bloomberg surveys of a panel of economists. Collected results are summarized as a median of forecasts, which is what we present here. **Past performance does not guarantee future results.**

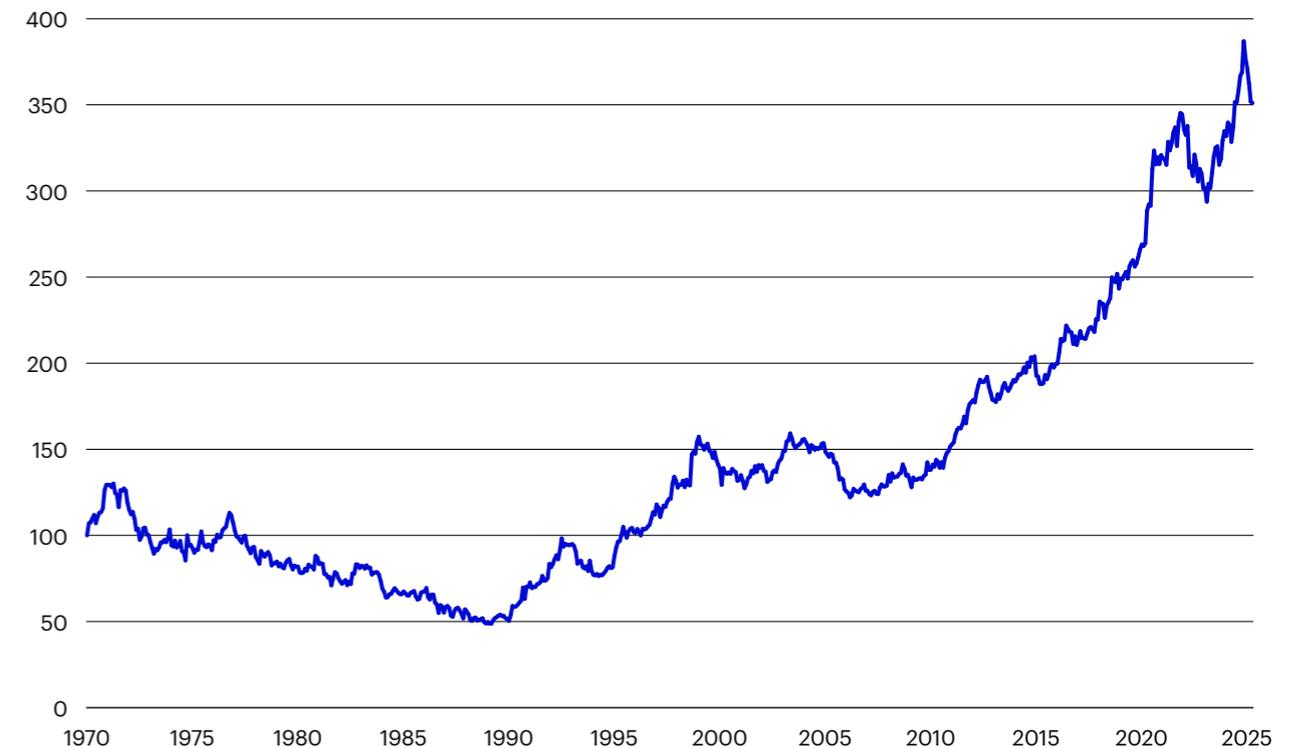
# An exceptional run for US stocks may be coming to an end

US stocks have outearned and commanded higher equity multiples than their peers in recent decades. However, valuation premiums are being questioned, and earnings growth differentials are closing versus Europe and China.

- Like the USD, US stocks have trumped most other equity markets since the Global Financial Crisis. While US multiples have expanded, the stocks that have helped propel US markets higher have generated far stronger earnings growth than peers.
- While the largest US tech names have continued to deliver strong earnings growth, the gap between growth in these names and others is starting to narrow, and the advent of comparable but cheaper AI models from China has led investors to question whether major US tech names deserve to command the multiples they have in the recent past.
- US equity valuations, particularly in market-capitalization-weighted strategies such as the S&P 500 Index, may have further to adjust if US economic conditions deteriorate. Markets outside of the US mostly trade at lower multiples, and we think the gap with the US will continue to narrow.
- Outside the US, the macro environment appears to be turning favorable. European markets should benefit from greater fiscal spending, an improving consumer backdrop and further rate cuts from the ECB. UK stocks provide investors with a very attractive valuation case plus high and reliable dividend yields. This market has a heavy weighting in financials, which should fare well as mortgage lending improves and interest rate curves steepen. Meanwhile, the Japanese economy is improving and inflation is back. Domestic investors are sitting on large piles of cash compared to their equity holdings and are now rotating from cash to stocks.
- In China, policymakers have also signaled that they want Chinese stocks to move higher, in addition to a desire to support growth in light of the trade war. We are reluctant to bet against the shifting tides of policy support.

## The end of US exceptionalism?

MSCI US vs. MSCI World ex US (Jan 1970 = 100), local currency, (Monthly data, from January 1970 to April 2025)



Sources: Invesco and Bloomberg L.P., as of 2 May 2025. Past performance does not guarantee future results.

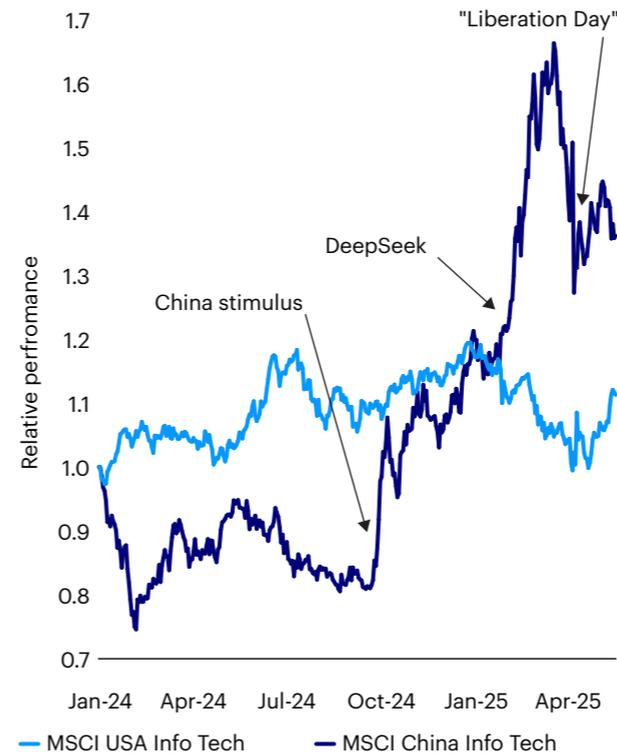
# China joins the US in artificial intelligence tech dominance

Chinese tech stocks look attractive, helped by tech breakthroughs like DeepSeek's R1, a supportive domestic policy backdrop, and flagging US tech stock enthusiasm.

- Since the release of ChatGPT in late 2022, artificial intelligence has been a US-led story, with most AI development taking place in and powered by the largest American technology companies. Yet in January 2025, the AI story shifted dramatically with the entrance of DeepSeek, a Chinese start-up that challenged investor assumptions about how much investment is needed, where value capture would take place, and which companies are the leaders in AI development. Indeed, since the DeepSeek news, a number of Chinese tech giants have announced competitive AI models.
- Investor enthusiasm for Chinese technology is on an upswing, stirred first by a ramp-up in Chinese domestic policy support and invigorated by January's DeepSeek news. And the tech story spans beyond AI, with China building momentum in electric vehicles and robotics as well.
- Despite the shift in market sentiment, valuations still remain tame. Compared to 10-year average forward price-to-earnings ratios, US technology stocks still look expensive, while Chinese tech stocks are roughly at their 10-year average. Shifting policy support and continued innovation suggest Chinese tech stocks can continue their recent outperformance, especially if US growth experiences a slowdown.
- In contrast, the US backdrop is challenged. Mega-capitalization tech stocks have seen sentiment cool and are generally regarded by investors as being at expensive valuations. While capital spending has continued at well above average rates, recent headlines have indicated a pullback on data center leasing and spending.
- Europe, meanwhile, continues to lag in the AI narrative, with less innovation, less dynamic economies, and a relative lack of cloud computing resources versus the US. Europe also has less high-tech manufacturing than the US or China, suggesting that the region will continue to underperform in the AI theme. We note, though, that the upcoming surge in defense spending and the expected broadening and deepening of Europe's military-industrial complex may force Europe to make new inroads in tech competitiveness.

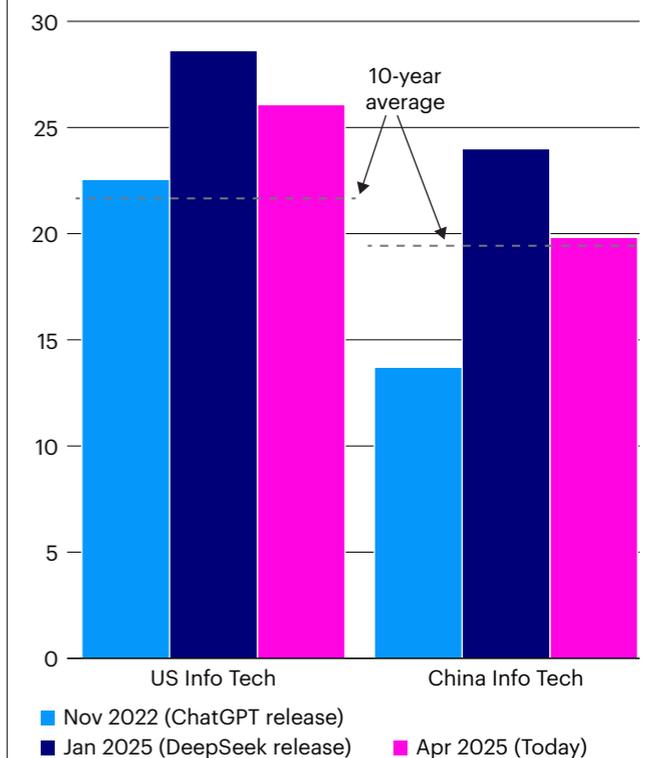
## China tech in favor

Relative performance vs. MSCI ACWI, (Daily data, from 2 January 2024 to 16 May 2025)



## China valuations still reasonably priced

Forward 12-month PE ratios



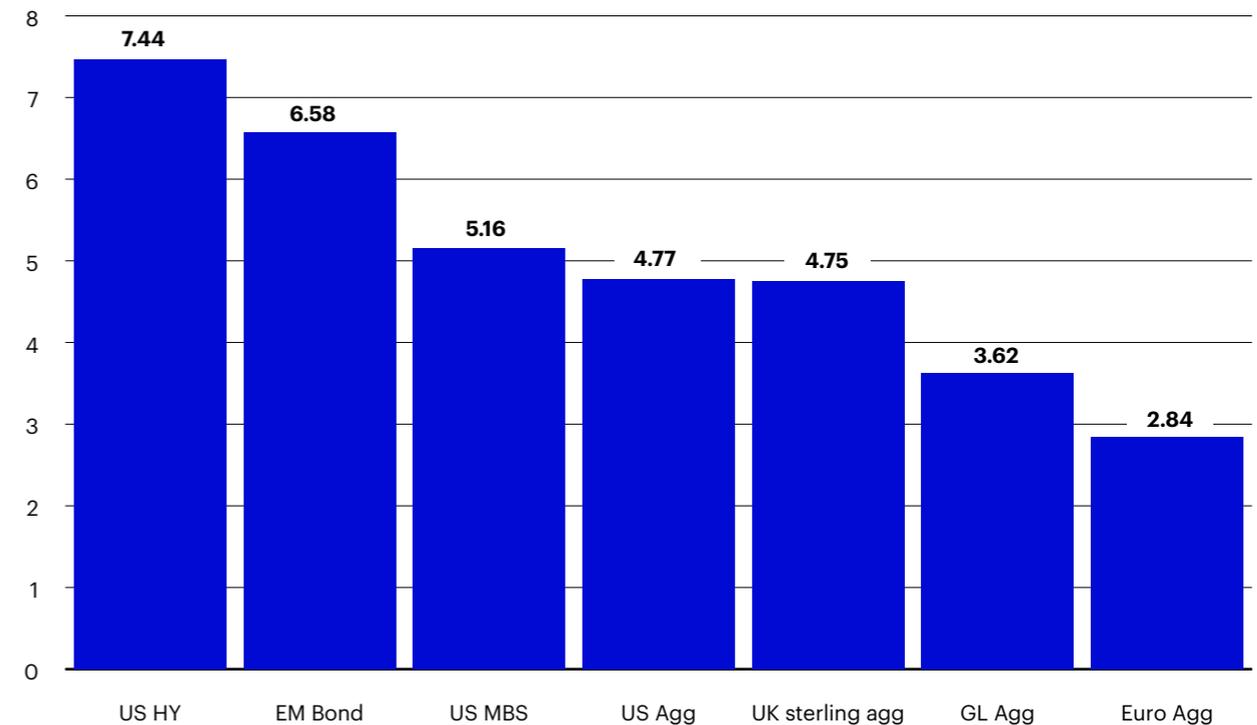
Note: ChatGPT release refers to the initial release of OpenAI's ChatGPT on 30 November 2022. "DeepSeek Release" refers to the popularization in financial media of DeepSeek's R1 model, which demonstrated impressive capabilities while showing less training and inference costs. R1 was released on 20 January 2025 and became a major topic in financial markets on 27 January. Info Tech indices based on MSCI USA and MSCI China indices. Sources: Bloomberg and Invesco, as of 23 April 2025. An investment cannot be made directly in an index. **Past performance does not guarantee future results.**

# Constructive on global bonds, neutral on US Treasuries

Potentially slower global growth due to trade uncertainty could drag global yields lower, but longer maturity US Treasury yields could rise on supply and budget deficit concerns.

- The potential for large tax cuts and an increased supply of Treasuries could put upward pressure on long-term US yields and lead to continued steepening in the US Treasury market.
- Global inflation appears to be sticky and above central bank targets for the near term, keeping central banks, especially the Fed, cautious about further rate cuts. We expect two to three Fed rate cuts in the second half of this year, but given the stickiness of inflation, the hurdle for rate cuts is now higher. Some emerging market central banks are likely to have more room to cut if the dollar moves lower.
- Global growth will likely slow but remain positive despite tariff headwinds. Europe and China have adopted pro-growth policies that should offset weakness. Europe has announced plans for historic increases in fiscal spending, which should support future growth, and China's stimulus should help maintain its growth trend despite the headwinds of their known debt load and deflation.
- Tariffs remain high by historical standards, notwithstanding relief provided by trade deals and implementation pauses, and there is still a risk that they could lead to a recession in the US. However, the underlying strengths of the US economy, such as high household net worth and low household and corporate debt, should support the economy, making any potential recession a shallow one.
- In credit, valuations still look tight across most sectors in our view. In a period of uncertainty and tight valuations, we think caution around risk-taking is appropriate. We favor a slight underweight across most credit sectors and a generally cautious approach to portfolio risk-taking.

Current yield-to-worst, %



Note: US HY = Bloomberg US High Yield Bond Index; EM Bond = Bloomberg Emerging Markets Hard Currency Aggregate Bond Index; US MBS = Bloomberg US Mortgage-Backed Securities (MBS) Index; UK sterling agg = Bloomberg Sterling Aggregate Bond Index; US Agg = Bloomberg US Aggregate Bond Index; GL Agg = Bloomberg Global Aggregate Bond Index; Euro Agg = Bloomberg EuroAggregate Bond Index. Sources: Bloomberg L.P., and Invesco, as of 29 April 2025. **Past performance does not guarantee future results.**

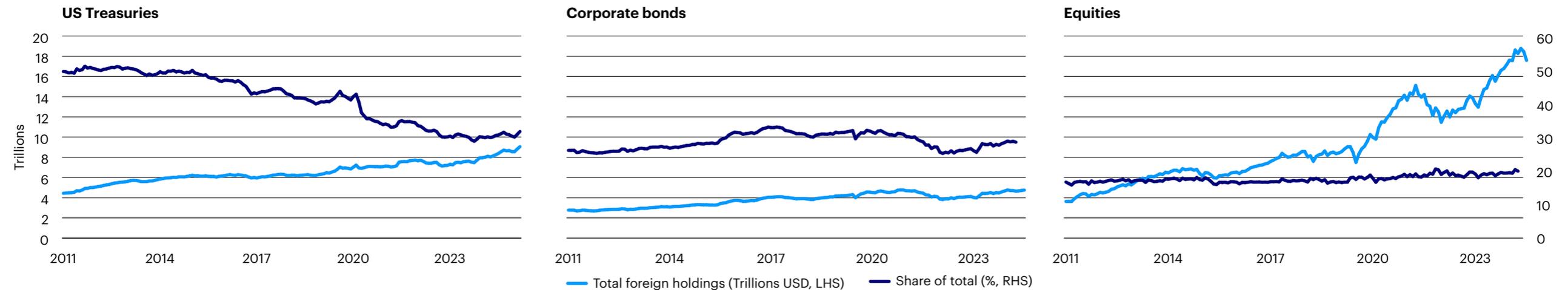
# Will the prolonged period of US economic outperformance continue?

Investors have long looked to the US as a stable power with deep and reliable capital markets, but some are now wondering whether US allocations should be pared back.

- Market participants, whether domestic or foreign, private or official, have historically viewed the US as a steward of global stability, a global shock absorber and a leader in tech, finance, and geopolitics. But now, some – including US investors – worry about a US government that does not shy away from producing policy shocks, stoking financial instability and generating economic uncertainty.
- An already high fiscal deficit is poised to widen further with tax cuts, potential recession risks and fears of slower trend growth. Structurally lower growth could result if investors reduce US portfolio concentrations and/or firms, entrepreneurs and skilled workers shift away from the US.
- A widespread reallocation away from US assets could cause a weakening of the US dollar and a rise in Treasury yields, increasing funding costs. The US Treasury puts foreign holdings of US financial assets in public markets at \$32.1 trillion. In contrast, US investors hold just half that, \$15.8 trillion, in foreign assets. If foreign investors in the US reallocate abroad, the USD and US risk premia would likely come under additional pressure.
- That said, we believe that while the loss of US policy credibility and its reputation as a reliable trading and investment partner is significant, it is not fatal. Recoveries in stocks, bonds, and the dollar have followed President Trump's pullbacks from his strongest threats on tariffs and Fed independence, changes that were prompted by both domestic pushback and market volatility. A more moderate, gradualist approach to addressing trade frictions and domestic political tensions, along with judicious deregulation and tax reform, could reinvigorate growth and potentially put US exceptionalism back on the table. After all, the US remains home to many of the world's most innovative companies and deep capital markets.

## Foreign investors own sizeable shares of US assets, especially debt

Foreign holdings of...



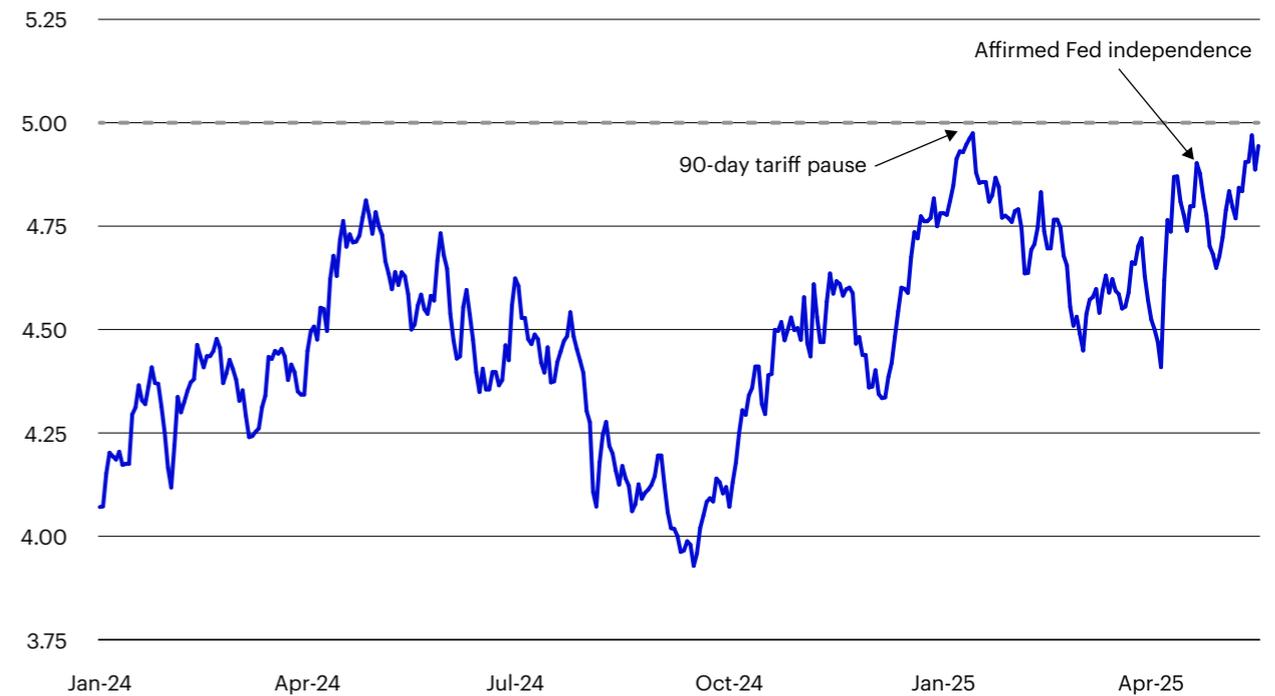
Note: Figures cited in text are as of March 2025, which is the latest available data as of 16 May 2025. Total foreign holdings for each category are calculated from Treasury International Capital flows as reported for Treasury securities, corporate stocks, and corporate bonds. Treasury securities include both short-term and long-term debt securities issued by the US Treasury and do not cover agency debt. Corporate stock figures do not include stock swaps. American Depositary Receipts (ADRs) are treated as foreign equity and do not appear in US equity data. Corporate bonds include a small amount of municipal bonds. Foreign shares of total outstanding securities are calculated using the previous figures compared against US Treasury data on total outstanding marketable securities, Federal Reserve Flow of Funds data on total outstanding corporate equity liabilities, and Flow of Funds data on outstanding corporate bond liabilities. Sources: US Treasury, Federal Reserve, and Invesco Global Market Strategy Office. Monthly and quarterly data from January 2011 to March 2025.

# What's the strike price of the "Trump put"?

President Trump's first term was accompanied by the "Trump put", where policy actions were reined in when markets reacted too negatively. While we have seen pullbacks under the new administration, it's not yet clear when and where lines are being drawn.

- Economic downturns and financial market crises have historically been alleviated by appropriate policy responses. However, in this instance, market volatility has been driven by the US administration's policies, making the response less clear if conditions worsen.
- During his first term, President Trump would often adjust or reverse policies if the market reacted negatively to them. The term "Trump put" is rooted in the idea that President Trump viewed the stock market as a measure of his success and would intervene to prevent significant declines.
- To this point, the US administration appears less concerned about the stock market but has shown a willingness to adjust course when there has been significant market dislocation and domestic political pushback. It may be a coincidence that the administration has taken measures to reassure the market each time the 30-year Treasury rate neared 5%. The volatility along the way may also be a factor, with the April events marked by sudden shifts in Treasury yields. Nonetheless, 30-year yields at or above 5% suggest a potential pain threshold for the administration.
- Looking forward, we think President Trump is serious about reordering global trade but now seems more likely to go more gradually, as well as tone down aggressive rhetoric against allies and adversaries when it comes to both trade tensions and other geopolitical controversies.

**The 5.00% mark on 30-year bonds may be the new line in the sand**  
 30-year US Treasury yield, %, (Daily data, from 2 January 2024 to 16 May 2025)



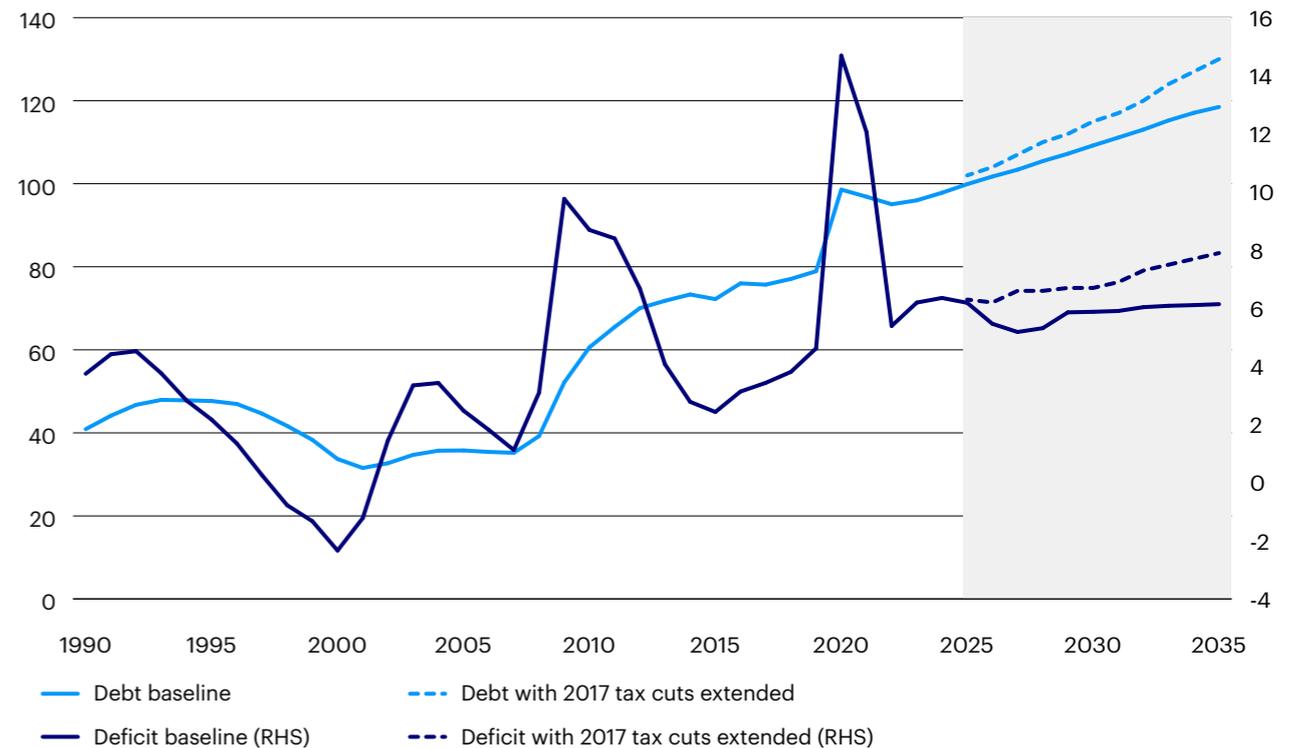
Sources: Bloomberg L.P., and Invesco, as of 5 May 2025. **Past performance does not guarantee future results.**

# US fiscal policy and the sustainability of government debt

The US economy has benefitted from a fiscal boost since the pandemic, but adjustments may be needed.

- As in other countries, the US government supported household and business cash flows during the pandemic. However, not only was the US government more generous than most others during this period (hence the build-up of larger excess savings in the US), it continued to support the economy afterward with initiatives such as the Inflation Reduction Act and the CHIPS Act.
- The downside was the accumulation of government debt, with Congressional Budget Office estimates suggesting that net government debt-to-GDP was 98% at the end of 2024 (the gross debt-to-GDP ratio was 122%).
- The extension of the TCJA (Trump 2017 tax cuts) and potential additional tax cuts discussed by the US administration are likely to put upward pressure on the US fiscal deficit, which is already at an uncomfortably large level.
- Hyperbolic comments around a US default should be discounted in our view, but there are refinancing risks looming, with approximately \$8T of coupon securities maturing by end-2027 and concerns that the administration's fiscal framework will mean larger deficits raising fears around sustainability. That could put upward pressure on UST yields.
- Again, we have full confidence that the US debt limit will be raised, but the federal government's cash and extraordinary measures will likely be exhausted sometime in August. The tensions around that period could also put pressure on USTs. For example, markets are starting to price US debt risks, as shown by CDS moving wider.

US federal deficit and debt estimates by CBO 1990-2035 (% of GDP)



Note: Annual data from 1990 to 2025, based on CBO (Congressional Budget Office) January 2025 estimates and supplementary estimates submitted to Congress in March 2025. Baseline estimates assume that the 2017 tax cuts will be reversed in 2025 (as was originally planned). "Tax cuts extended" variants assume those tax cuts are not reversed. "Deficit" is the total deficit and "debt" is net debt held by the public.

Sources: US Congressional Budget Office and Invesco Global Market Strategy Office.

# Can Europe escape a hit to growth from the trade war?

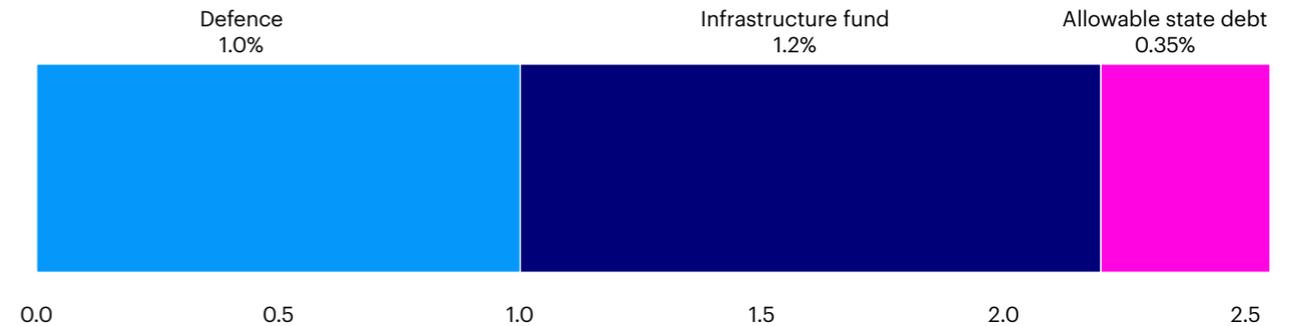
Direct European exports to the US equate to around 3% of European GDP, suggesting that tariffs pose a limited but significant headwind to exports. However, auto manufacturing capacity is being repurposed for defense.

- On March 3, Germany's new Chancellor, Friedrich Merz, channeled his inner Mario Draghi, saying that Germany would "do whatever it takes" to ensure the defense of Europe. Shortly after, restrictions on the German debt brake were lifted, and Merz committed to greater defense and infrastructure spending, amounting to nearly 2.5% of German 2024 GDP.<sup>1</sup>
- In the last two years, German defense spending has increased and these funds are finding their way to European defense manufacturers more than to US shores. The conduct of war has changed in recent years, with drones and cheaper weapons playing a much larger role than traditional arms. European and Ukrainian firms are better placed to supply this equipment, suggesting the fiscal multipliers should be positive for Europe in the coming years.
- The European consumer is also starting to spend more and save less. Europe is a more rate-sensitive market than the US, and the ECB has led this cutting cycle, pushing borrowing costs lower and helping raise demand for household loans.
- The ECB is likely to cut policy rates more quickly than previously expected as lower oil prices and the stronger euro lead to growing disinflationary pressures in the eurozone. Further, while US tariffs will put upward pressure on prices in the US, European goods prices may see disinflationary pressure as excess supply from China and other regions is diverted from the US to Europe.
- European growth will likely experience a hit from US tariffs, but we think increased German infrastructure and European defense spending generally, coupled with a consumer recovery, will enable Europe to weather this storm.

1. The fiscal package includes a combination of increases in spending as well as an increase in allowable fiscal deficits for specific categories of spending. The figures here assume a €500 billion German infrastructure investment fund spent evenly across 10 years; an increase in defense spending of 1% of GDP per year; and a rise in the net borrowing cap for federal states from 0% to 0.35% of GDP.

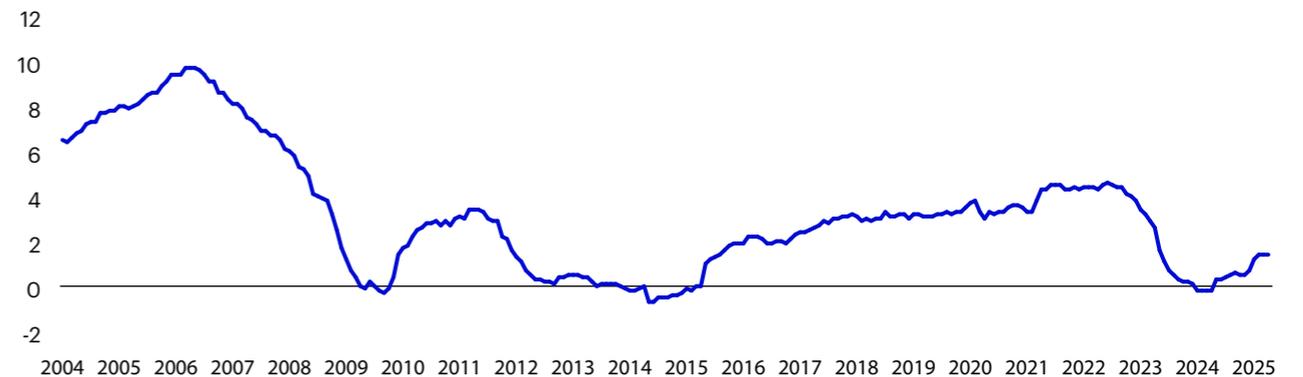
## Doing whatever it takes

Combined increase in fiscal allowances as % of GDP<sup>1</sup>



## European households are borrowing more

Eurozone loans to households y/y %, (Monthly data, from January 2004 to April 2025)



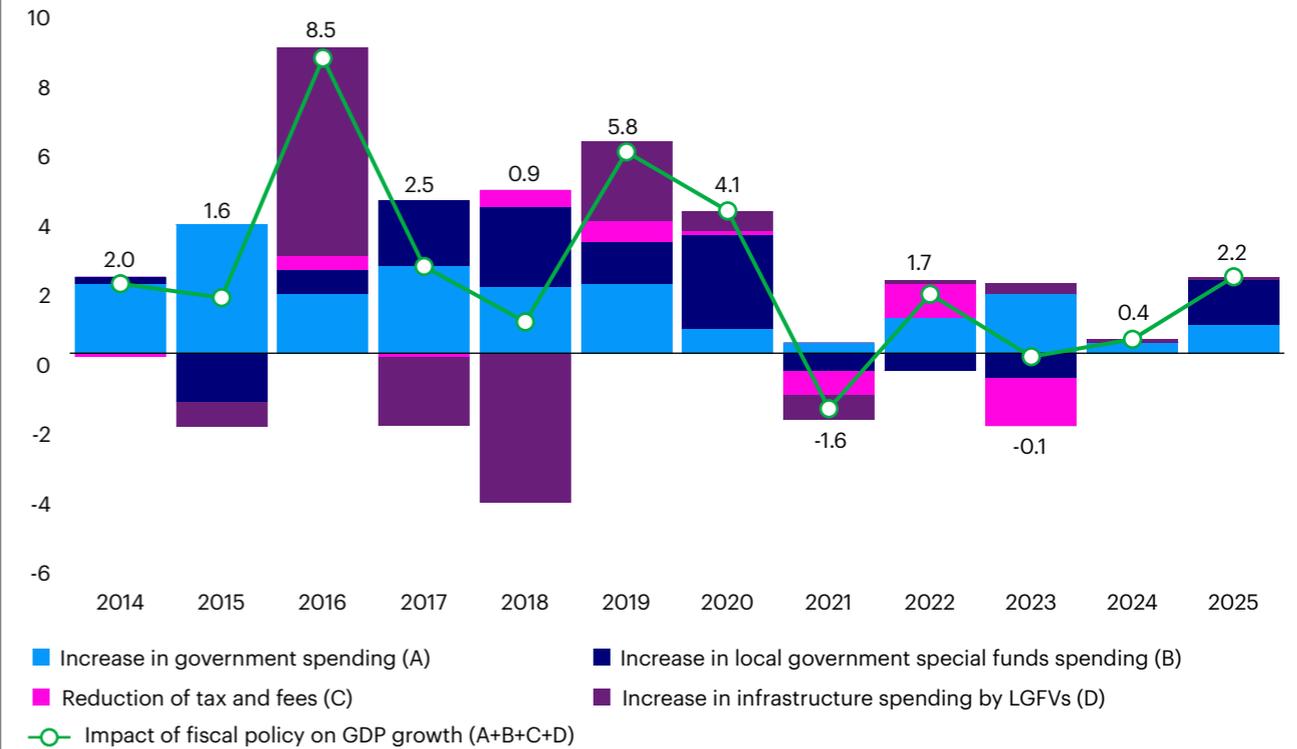
Sources: Invesco and Bloomberg L.P., as of 30 April 2025.

# Does China have the economic tools to counter tariff headwinds?

China has been expanding monetary and fiscal measures, and we are seeing green shoots of better domestic growth and consumption. We think China has sufficient stimulus tools to buttress growth this year.

- US tariff policy remains a challenge for China, notwithstanding the US administration's pullback from initially announced levels. It is worth noting that China is less reliant on the US than in previous decades, with its direct exports to the US representing a relatively small part of total Chinese GDP (which is also the case for Europe).
- China's economic data so far this year has positively surprised relative to expectations. Domestic auto sales have improved, mortgage lending is showing signs of having bottomed, and the most recent May Golden Week data shows an improvement in consumer spending.
- We anticipate that Chinese authorities are likely to further support household demand and private enterprise capex in the coming months in order to achieve an "around 5%" growth target for this year. If China delivers, this should lead to outperformance of China's economic growth relative to the rest of the world, which could benefit investors overweighting Chinese equities.
- China's policy has turned more stimulative with its 2025 budget. Chinese authorities have set out to support consumption, while aiming to facilitate high-tech development. Notably, measures to boost household consumption such as the recent appliances trade-in program coupled with the issuance of ultra-long-term government bonds, appear to have yielded favorable results. We expect policymakers to roll out further measures to boost consumption this year in the face of tariff uncertainties.

**China's stimulus has picked up significantly in 2025**  
 Estimated impacts of fiscal policy on GDP growth, % of GDP



Note: In estimating the impacts of fiscal policy on GDP growth, increase in government spending and increase in local government special funds spending are considered to fully contribute to GDP growth, while only half of the amount of reduction in tax and fees is considered to contribute to GDP growth. Actual figures until 2024. Planned figures for 2025. Figures for LGFVs (Local Government Financing Vehicles) are estimated by IMF.

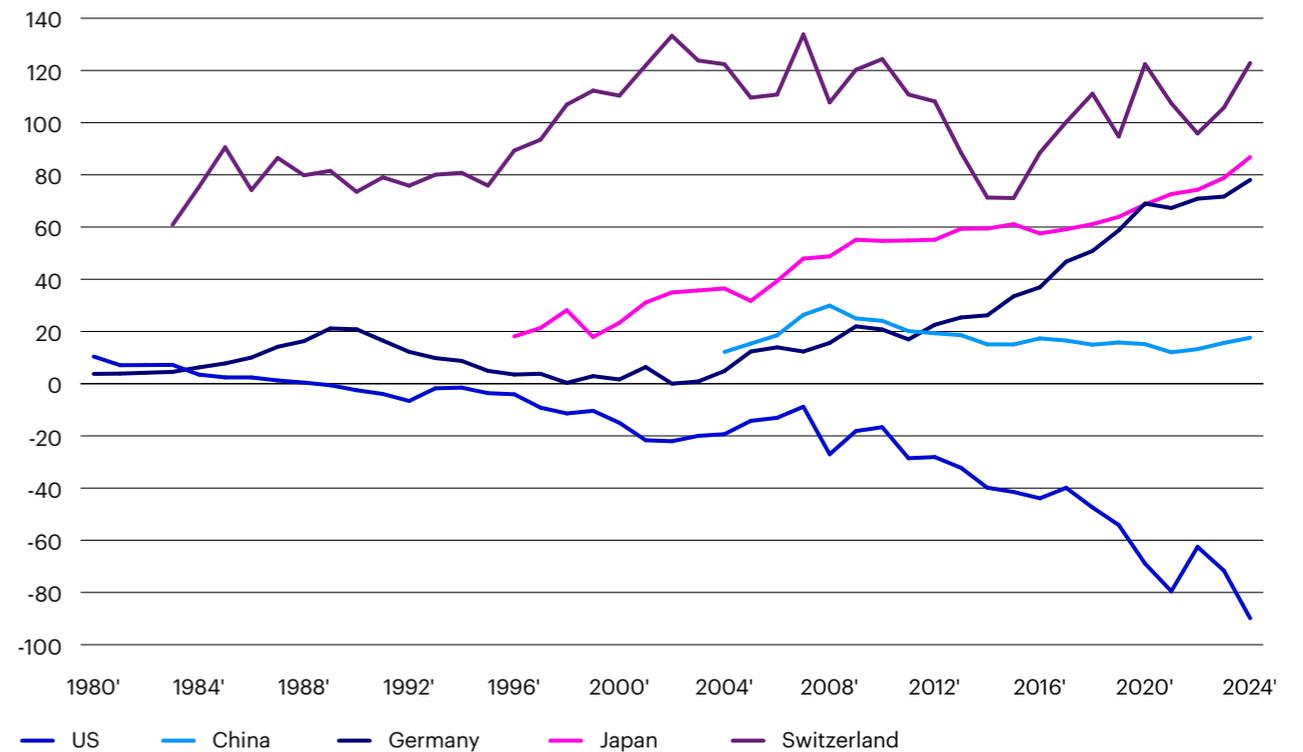
Sources: Invesco from China's Ministry of Finance, Xinhua News Agency and IMF, as of 30 April 2025.

# Where are the attractive safe-haven\* assets today?

During bouts of uncertainty, investors tend to repatriate funds, suggesting upward pressure on the currencies of creditor countries.

- During times of economic uncertainty and market volatility, Treasury yields typically fall as investors seek refuge in 'safe-haven' assets. Sometimes, the dollar strengthens, though not always.
- There were periods in the first half of 2025 when US Treasury yields rose while the dollar weakened. During periods of market volatility, there is a tendency for capital to be repatriated, which explains why the Swiss franc and Japanese yen tend to appreciate in turbulent markets (both countries have large net overseas asset positions). We suspect that will continue, to the detriment of the dollar. The bond markets of Switzerland and Japan government could see inflows under such circumstances, helping to depress their yields. The same applies to German bunds.
- Though gold can be volatile, it is often considered to be a 'safe haven'. That haven quality has been in strong demand since Russian central bank reserves were sanctioned by the US in 2022. Other central banks took note and, in recent years, have been adding to their gold reserves as they seek to reduce their reliance on USD assets. We see little reason to think central bank demand for gold should fade materially. Physical demand for gold in the US and China has been strong, too, and more recently, ETF demand has also improved. And while gold has risen a lot in recent years, it still provides diversification benefits to portfolios.

Net international investment position (% of GDP)



Notes: annual data from 1980 to 2024. Net international investment position is net overseas assets minus net overseas liabilities. Source: IMF, LSEG Datastream and Invesco Global Market Strategy Office.

\* So called safe-haven assets do not imply risk-free investments. Opinions expressed are those of the Global Market Strategy Office. This commentary does not constitute buy/sell recommendations.

# Appendix

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## Index definitions :

- **Tightening monetary policy** includes actions by a central bank to curb inflation.
- **Easing monetary policy** refers to the lowering of interest rates and/or deposit ratios by central banks.
- The **yield curve** plots interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates to project future interest rate changes and economic activity.
- **Yield curve steepening** is when the spread of longer-dated bonds versus short-dated bonds grows larger. This may be measured as 10-year yields minus 2-year yields, for example.
- The **Fed Funds Rate** is the benchmark short-term interest rate level set by the Federal Open Market Committee.
- **Gross Domestic Product (GDP)** is a measure of all of the goods and services produced within an economy during a year.
- **S&P 500® Index** is a market-capitalization-weighted index of the 500 largest domestic US stocks.
- The **MSCI USA Price Index** is a market-capitalization-weighted index of large-cap stocks in the US domestic market.
- The **MSCI World ex US Local Currency Price Index** is an unmanaged index considered representative of stocks of developed countries excluding the United States.
- The **MSCI USA Information Technology (Info Tech) Index** is an unmanaged index that tracks the performance of large-cap information technology stocks in the United States, measured in US dollar terms.
- The **MSCI China Information Technology (Info Tech) Index** is an unmanaged is an unmanaged index that tracks the performance of large-cap information technology stocks in China, measured in Hong Kong dollar terms.
- The **MSCI All Country World Index** is an unmanaged index considered representative of large- and mid-cap stocks across developed and emerging markets.
- **Forward 12-month PE ratios** are the ratio of the current trading price of a given index versus the expected annual earnings estimated 12 months in the future.
- The **yield-to-worst** of a bond is a measurement that seeks to describe the lowest possible return an investor can realize from a bond, exclusive of taxes. It seeks to control for bond features such as embedded call options.
- The **Bloomberg US High Yield Corporate Bond Index** is an unmanaged index considered representative of the US USD-denominated, fixed-rate high yield corporate bond market.
- The **Bloomberg Emerging Markets Hard Currency Aggregate Bond Index** measures the performance of hard currency emerging markets (EM) debt, including fixed and floating rate US dollar-denominated debt issued from sovereign, quasi-sovereign, and corporate EM issuers.
- The **Bloomberg US Mortgage-Backed Securities (MBS) Index** is an unmanaged index that seeks to measure the performance of the fixed-rate agency mortgage-backed security market.
- The **Bloomberg Sterling Aggregate Bond Index** is a flagship benchmark that measures the investment grade, sterling-denominated, fixed-rate bond market, including treasuries, government-related, corporate and securitized issues.
- The **Bloomberg US Aggregate Bond Index is an unmanaged index** considered representative of the US investment grade, fixed-rate bond market.
- The **Bloomberg Global Aggregate Bond Index is an unmanaged index** considered representative of global investment grade, fixed income markets.
- The **Bloomberg Euro Aggregate Bond Index** is a broad-based benchmark that measures the investment grade, euro-denominated, fixed-rate bond market, including treasuries, government-related, corporate and securitized issues.
- **US Dollar Index**, unless otherwise specified, is represented by the DXY Dollar Index, which measures the value of the US dollar relative to a basket of foreign currencies.

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## Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations), and investors may not get back the full amount invested. **Past performance is not a guide to future returns.**

Currencies and futures generally are volatile and are not suitable for all investors.

The health care industry is subject to risks relating to government regulation, obsolescence caused by scientific advances and technological innovations.

High yield securities involve greater risk and are less liquid than higher grade issues. Changes in general economic conditions, financial conditions of the issuers and in interest rates may adversely impact the ability of issuers to make timely payments of interest and principal.

Economic problems in certain US states increase the risk of investing in municipal obligations, such as California, New York or Texas, including the risk of potential issuer default, heightens the risk that the prices of municipal obligations, and the fund's net asset value, will experience greater volatility. See the prospectus for more information.

Alternative investment products, including hedge funds and private equity, involve a high degree of risk, often engage in leveraging and other speculative investment practices that may increase the risk of investment loss, can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing important tax information, are not subject to the same regulatory requirements as mutual funds, often charge high fees which may offset any trading profits, and in many cases the underlying investments are not transparent and are known only to the investment manager. There is often no secondary market for hedge funds and private equity, and none is expected to develop. There may be restrictions on transferring interests in such investments. Rental inflation is the increase in the cost to rent a home.

Stocks of small-capitalization companies tend to be more vulnerable to adverse developments, may be more volatile, and may be illiquid or restricted as to resale than large companies.

A value style of investing is subject to the risk that the valuations never improve or that the returns will trail other styles of investing or the overall stock markets.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Many products and services offered in technology-related industries are subject to rapid obsolescence, which may lower the value of the issuers.

Commodities may subject an investor to greater volatility than traditional securities such as stocks and bonds and can fluctuate significantly based on weather, political, tax, and other regulatory and market developments.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Investments in real estate related instruments may be affected by economic, legal, or environmental factors that affect property values, rents or occupancies of real estate. Real estate companies, including REITs or similar structures, tend to be small and mid-cap companies and their shares may be more volatile and less liquid.

Alternative products typically hold more non-traditional investments and employ more complex trading strategies, including hedging and leveraging through derivatives, short selling and opportunistic strategies that change with market conditions. Investors considering alternatives should be aware of their unique characteristics and additional risks from the strategies they use. Like all investments, performance will fluctuate. You can lose money.

Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

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