Quarterly base-case scenario

CIO Office | Q2 2025

World upside down

After starting 2025 confident that the new U.S. administration would prioritize policies that would promote growth and limit inflation, markets quickly had to revise their expectations in the face of the rashness with which President Trump wielded – and acted upon – the tariff threat. Yet, while this context generated a general increase in volatility on financial markets, the irony is that U.S. stocks ended the quarter more affected than the equities of the countries targeted by the tariffs, with the S&P 500 dragged down by its tech giants, whose exceptionalism is increasingly being called into question. On the other hand, while the S&P/TSX escaped without too much damage, the biggest surprise came from the strong outperformance of European equities, as American hostility helped create a sense of urgency for more pro-growth fiscal policies in Germany.

On the macroeconomic front, the story of the first quarter can be summed up in three points. Firstly, the realization that 2025 will inevitably see lower economic growth and higher inflation than previously expected, as a direct consequence of increased U.S. tariffs that far surpass those put in place during the 2018 trade war. Secondly, the high degree of uncertainty that is bound to surround any economic outlook as the U.S. administration's agenda unfolds, as will the reaction of the rest of the world. Finally, the emergence of certain signs that uncertainty itself is beginning to adversely impact U.S. consumers, who, it should be remembered, are the cornerstone of economic growth in the United States.

Consequently, recession risks have undeniably increased since the last quarter, and the reaction of the labour market – which remains in good shape for the time being – will need to be closely monitored for further clarity in the months ahead. Nevertheless, our baseline scenario still sees the economy growing at a moderate pace, albeit with above-target inflation to contend with for some time to come.

In this volatile environment, we maintain a balanced allocation between equities and bonds, as we see these two asset classes as presenting complementary risk profiles and similar return prospects over a twelve-month horizon. Geographically, we reduced the size of our overweight in North American equities at the end of February and remain on the lookout for signals likely to support a sustained rotation toward international equity markets.

All in all, we believe that now is not the time for high-risk strategies, and we encourage investors to remain diversified rather than trying to predict – and take positions on – a fundamentally unpredictable U.S. administration.

	Q2 2025	Key elements and investment implicationss
Bull case	**Above-trend growth (10%)**	• The U.S. labour market strengthens, inflation stagnates near 3%. The Fed keeps rates on hold. • Trade tensions ease, bilateral negotiations begin. Uncertainty fades, but Europe, China and Canada continue to support their economies through pro-growth fiscal measures. • In the U.S., business sentiment improves on the back of more accommodative regulatory and fiscal policies, while consumer spending remains supported by strong real wage growth. **Economic implications:** Real GDP growth > 2%, stable unemployment rate around 4% **Market implications:** ↑Equities, ↑Bond yields, ↓Volatility, ↓USD
Base case	**Sub-trend growth (60%)**	• The U.S. labour market weakens slightly, inflation stagnates near 3%. • The Trump admin imposes extensive tariffs and opens the door to negotiations, albeit with little urgency. Focus turns to tax cuts. • After a pause, the Fed cuts its policy rate in the neutral range in the second half of the year, while the Bank of Canada moves into slightly accommodative territory. • Fiscal expansion outside of the United States cushions the tariff shock on global growth. **Economic implications:** Real GDP growth between 1-2%, U.S. unemployment rate near 4.5% **Market implications:** ↕Equities, ↕Bond yields, ↑Volatility, ↕USD
Bear case	**Recession (30%)**	• The U.S. labour market weakens rapidly, inflation slows but is partly held up by higher tariffs. • The Trump administration's policies backfire. U.S. trading partners announce major retaliatory measures, while cuts in federal spending and jobs lead to unexpected setbacks. • Initially hesitant, central banks eventually cut their policy rates to accommodative territory. • Faced with uncertainty, households increase savings and reduce spending. **Economic implications:** Real GDP contraction, U.S. unemployment rate above 4.5% **Market implications:** ↓Equities ↓Bond yields, ↑↑Volatility, ↑USD

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General

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